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PRIVATELY-FINANCED INFRASTRUCTURE PROJECTS*

Draft chapters of a legislative guide on privately-financed infrastructure projects

Report of the Secretary-General

1. At its twenty-ninth session, in 1996, the Commission decided to prepare a legislative guide on build-operate-transfer (BOT) and related types of projects.[1] The Commission reached its decision after consideration of a report prepared by the Secretary-General which contained information on work being undertaken by other organizations in that field, as well as an outline

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* The Commission may wish henceforth to use the words "privately-financed infrastructure projects" to refer to its work in this field, rather than the words "build-operate-transfer" (BOT), which had so far been used. Although sometimes used as a generic expression for different forms of private financing of public infrastructure projects, in its literal meaning "BOT" refers only to one particular type of infrastructure project with private funding. However, as the practice in this field continues to evolve, various different types of arrangements are developed which do not fall under the pure "BOT" category, such as "build-own-operate" (BOO), "build-own-operate-transfer"(BOOT), "build-own-lease-transfer" (BOLT) or "build-rent-transfer" (BRT), to name but a few. The proposed words are intended to make it clear that the Commission's work in this field covers all arrangements for the development of public infrastructure projects involving private financing, including, but not limited to, BOT arrangements.

[1] Report of the United Nations Commission on International Trade Law on the work of its twenty-ninth session, *Official Records of the General Assembly, Fifty-first Session, Supplement No. 17* (A/51/17), paras. 225-230.

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of issues covered by national laws concerning those arrangements.[2]

2. It was reported that, unlike publicly-funded projects, in which the Government is responsible for the entire implementation of the project, including for obtaining financing and guaranteeing its repayment, in the case of privately-financed infrastructure projects the Government engages a private entity to develop, maintain and operate an infrastructure facility in exchange for the right to charge a price, either to the public or to the Government, for the use of the facility or the services or goods it generates.

3. In its deliberations, the Commission noted the interest that BOT and other forms of private participation in public infrastructure projects had raised in many States, in particular in developing countries, as the successful implementation of such projects would enable States to achieve significant savings in public expenditure and to re-allocate resources that otherwise would have been invested in infrastructure in order to meet more pressing social needs. Furthermore, since the project is built and, during the concession period, operated by the project company, the country benefits from private sector expertise in operating and managing the relevant infrastructure facility. The Government may expect in particular to achieve efficiency gains and high standards of service, which sometimes may not be provided by self-regulated State monopolies.

4. It was noted, however, that BOT and similar projects could be quite complex and that their implementation required a favourable legal framework that fostered the confidence of potential investors, national and foreign, while protecting public interests. Thus, the Commission considered that it would be useful to provide legislative guidance to States preparing or modernizing legislation relevant to those projects. Pursuant to a request by the Commission, the Secretariat has reviewed issues suitable for being dealt with in a legislative guide and has prepared draft materials for consideration by the Commission, which are submitted with this report.

5. The document contained in annex I to this report contains a table of contents setting out the topics proposed to be covered by the legislative guide, which are followed by annotations in some detail concerning the issues suggested to be discussed therein. Those annotations are offered for the purpose of enabling the Commission to make an informed decision on the proposed structure of the legislative guide and its contents. In preparing that document, the Secretariat considered a number of issues which have often been addressed in national laws and regulations pertaining to privately-financed infrastructure projects. However, it is not suggested that the legislative guide should recommend that all of those issues be dealt with at the legislative level, and it is proposed to consider in the legislative guide the desirability of dealing with some of them in legislation, while leaving others to be addressed by the parties in the agreements concerning the implementation of the project.

6. For the purpose of providing the Commission with a clear view of the style and level of

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[2] Document A/CN.9/424.

detail envisaged for the legislative guide, the Secretariat has also prepared initial drafts of chapter I, "Scope, purpose and terminology of the Guide", chapter II, "Parties and phases of privately-financed infrastructure projects" and chapter V, "Preparatory measures" (Addenda 1 to 3 to this document)

7. In preparing the draft materials, the Secretariat has borne in mind the need to keep the appropriate balance between the objective of attracting private investment for infrastructure projects and the protection of the interests of the host Government and the users of the infrastructure facility.

8. The Commission may wish to provide comments on the proposed structure of the legislative guide and guidance on the issues suggested to be discussed therein, so as to allow the Secretariat to prepare the remaining draft chapters of the legislative guide for the next session of the Commission, in 1998.

Annex I

DRAFT LEGISLATIVE GUIDE ON PRIVATELY- FINANCED INFRASTRUCTURE PROJECTS

ANNOTATED TABLE OF CONTENTS

INTRODUCTION

A. Origin of the *Guide*
B. Arrangement of the *Guide*
C. Recommendations and illustrative provisions

Note

1. As was the case of the introductions contained in the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works* and in the *UNCITRAL Legal Guide on Countertrade Transactions*, it is suggested that the *Introduction* explain the origin of the *Guide*, its arrangement and style, the nature of its recommendations and provide other information of a similar nature.

I. SCOPE, PURPOSE AND TERMINOLOGY OF THE *GUIDE*

A. Transactions covered by the *Guide*
B. Purpose of the *Guide*
C. Terminology used in the *Guide*

Notes

2. It is suggested to provide, in the opening chapter of the *Guide*, information on the transactions it covers and on the purpose of the *Guide*, as well as an explanation of terms frequently used in the *Guide*.

3. An initial draft of chapter I is contained in document A/CN.9/438/Add.1.

II. PARTIES AND PHASES OF PRIVATELY-FINANCED INFRASTRUCTURE PROJECTS

A. General remarks
B. Private sector and public infrastructure
C. The concept of project finance
D. Parties to the project
    1. The host Government
    2. Project sponsors and project company
    3. Lenders and international financial institutions
    4. Other capital providers

5. Construction contractors and suppliers
6. Operation and maintenance company
7. Insurers

E. Phases of execution
1. Identification of the project
2. Selection of project sponsors
3. Preparations for the implementation of the project
4. Construction phase
5. Operational phase
6. Termination of the project

Notes

4. As an introduction to privately-financed infrastructure projects, it is proposed that chapter II contain general remarks on the concept of project finance, the parties to a privately-financed infrastructure project and the phases of its implementation. The purpose of chapter II is to provide the reader with background information and to facilitate making an informed choice of possible legislative solutions for the issues subsequently discussed in the *Guide*.

5. An initial draft of chapter II is contained in document A/CN.9/438/Add.2.

III. GENERAL LEGISLATIVE CONSIDERATIONS

A. Legal framework for privately-financed infrastructure projects
1. Legislative authorization
2. Legislative approaches to infrastructure projects

B. Other relevant areas of legislation
1. General business laws and property law
2. Settlement of disputes
3. Investment and taxation laws

C. National legislation and international agreements
1. International investment protection agreements
2. International trade instruments

Notes

A. Legal framework for privately-financed infrastructure projects

6. In the opening section of chapter III it is proposed to discuss two issues concerning the general legal framework for privately-financed infrastructure projects, namely, the legislative authorization for the host Government to undertake such projects and the legal regime to which they are subject.

7. The implementation of privately-financed infrastructure projects may require the enactment of legislation or the adoption of special regulations, particularly in those countries where the Government alone carries the responsibility for providing "public services", or for building or

expanding infrastructure. In countries with a well established tradition of awarding concessions to the private sector for the provision of "public services", or the development of "public works", there may be general rules providing that, in principle, any activity carried out by the State which has an economic value that makes it capable of being exploited by private undertakings may be entrusted to the private sector. Sometimes, such general legislation identifies those fields of activity or types of infrastructure that may be provided or developed by private entities. A different approach is to be found in countries that do not have such general legislation and that have preferred to enact specific laws covering privately-financed projects in particular fields of activity. In some countries, as a matter of legislative practice, it was considered appropriate to adopt specific legislation regulating the execution and operation of one or more individual projects. It is proposed to discuss the possible advantages and limitations of both general and project-specific or sector-specific legislation and the possibility of a combined approach of general and sector-specific legislation.

8. In adopting general or specific legislation, a number of States have found it desirable to issue some form of declaration of policy concerning private sector participation in public services and utilities, or an explanation concerning the objectives being pursued by the host Government. Declarations of policy may be useful means of reassuring potential sponsors, other equity investors and lenders of the governmental support to privately-financed infrastructure projects in the host country. Also, a public manifestation by the host Government of its commitment to pursue a policy favourable to privately-financed infrastructure projects may serve an educational purpose by informing the public about how it is expected that the governmental policy on privately-financed public infrastructure projects would generate benefits to the country.

9. Another issue proposed to be discussed concerns the legal regime of privately-financed infrastructure projects. In some countries, the relations between the project company and the host Government are regarded as being of a contractual nature, therefore placing both parties in a position of essential equality. In other countries, particularly in a number of civil law jurisdictions, privately-financed infrastructure projects fall under well-defined categories and rules of a body of law often referred to as "administrative law" (see chapter I, "Scope, purpose and terminology of the *Guide*"). The practical consequences of those different approaches to the legal regime of the agreement between the project company and the host Government may be considerable.

B. Other areas of legislation relevant to privately-financed infrastructure projects

10. In addition to issues pertaining to legislation immediately relevant for privately-financed infrastructure projects, it is proposed to consider in a separate section the possible impact of other areas of legislation to the successful implementation of those projects.

11. The business laws of the host country play a very important role in facilitating the implementation of the project. A privately-financed infrastructure project is often carried out by a company especially established by the project sponsors for that purpose. It is therefore important for the host Government to have an adequate company law with modern provisions on essential matters such as establishment procedures, management structure, issuance of shares, bonds and debentures and their sale or transfer, accounting and financial statements, protection of minority shareholders. Also, it is important that the national laws on commercial contracts and

securities provide adequate solutions to the needs of the project company and the lenders, including the possibility of assigning receivables generated by the project and flexibility in devising contracts as needed for the construction and operation of the infrastructure facility. Routine transactions of the project company may be further facilitated by adequate commercial banking legislation. Modern solutions for a number of relevant commercial law issues may be found in existing international legal instruments, including conventions and model laws that emanate from the work of UNCITRAL, such as the United Nations Convention on Contracts for the International Sale of Goods, the UNCITRAL Model Law on International Credit Transfers, the United Nations Convention on Independent Guarantees and Stand-By Letters of Credit, the UNCITRAL Model Law on Electronic Commerce.

12. It is also desirable that the property laws of the host country reflect modern acceptable standards and contain adequate provisions on the ownership and use of land and buildings, as well as moveable property and intellectual property (copyrights, trademarks), ensuring the project company's ability to purchase, sell, transfer and licence the use of property, as appropriate. Particularly as regards the protection of intellectual property, a legal framework may be provided by adherence to international agreements regarding the protection and registration of international property rights.

13. Another important factor for the implementation of privately-financed infrastructure projects is the legal framework in the host country for the settlement of disputes. Project sponsors, contractors and lenders may be encouraged to participate in projects in countries that provide a hospitable and internationally acceptable legal climate for the settlement of disputes, as offered by the UNCITRAL Model Law on International Commercial Arbitration. The efficiency of the national judicial system, the expeditiousness of court proceedings and the availability of forms of judicial relief that are adequate to commercial disputes are additional factors to be taken into account, as well as the possibility of recognition and enforcement of foreign arbitral awards.

C. National legislation and international agreements

14. In the last section of chapter III it is proposed to consider the possible relevance for the laws of the host country governing privately-financed infrastructure projects of international agreements on the facilitation and promotion of global or regional trade in goods and services.

15. Those international agreements may contain provisions on the removal of barriers for the importation of goods or for the provision of services by foreigners in their contracting States. Provisions of that type may be relevant for national legislation on privately-financed infrastructure projects which contemplate restrictions on the participation of foreign companies in infrastructure projects, or establish preferences for national entities, or for the procurement of supplies in the local market.

16. One matter of particular concern for the project sponsors and the lenders is the degree of protection afforded to foreign investment in the host country. Such protection may derive from international agreements entered into by the host country for the encouragement and protection of foreign investment. The confidence of foreign investors in the host country may be fostered, for example, by protection from nationalization or dispossession without judicial review and adequate

compensation. Prospective project sponsors will also be concerned about their ability to transfer abroad or repatriate their profits. Another way of attracting foreign investment may consist in providing special tax regimes for private investors, such as exemption from corporate tax or other taxes, exemption from income tax for foreign personnel required to staff the project, exemption from real estate tax, tax concession on royalties, import duties.

IV. SELECTION OF THE PROJECT SPONSORS

A. General remarks
B. Possible methods for selecting the project sponsors
   1. Public tendering
   2. Request for proposals
   3. Direct negotiations
   4. Unsolicited proposals
C. Qualification criteria
   1. Requirements relating to the project sponsors
   2. Domestic preferences
D. Selection process
   1. Prequalification phase
   2. Invitation and proposals
   3. Evaluation and project award

Notes

A. General remarks

17. It is proposed that the opening section of chapter IV discuss general issues and possible approaches relevant for establishing an adequate legislative framework for the choice of methods and procedures for selecting the project sponsors. One important step is for the host Government to establish clearly the nature and scope of the works and services being procured. Also, the role envisaged for the private sector in any given case (for instance, whether the facility will be permanently or temporarily owned by the project company or whether it will be transferred to the host Government at the end of a certain period) might require special consideration by the host Government in devising qualification requirements and evaluation criteria. Furthermore, it is important to give appropriate weight to the long-term requirements of the operation of the facility which may be neglected if the law were to overemphasize the requirements of the construction phase for the purpose of selecting the project sponsors.

B. Possible methods for selecting the project sponsors

18. It is suggested that a section examine methods commonly used for the procurement of goods and services and consider their adequacy for infrastructure projects, particular attention being given to the UNCITRAL Model Law on Procurement of Goods, Construction and Services. Competitive methods are often referred to in national laws relating to privately-financed public infrastructure projects as primary or sole methods for selecting the project sponsors. Public tendering is the most common method for public procurement of goods and, in some cases, also services to be paid with public funds. However, given the complex nature of infrastructure

projects, alternative competitive methods, such as the "request for proposals" procedure, are sometimes preferred for the selection of the project sponsors.

19. In addition to competitive methods, other methods are sometimes referred to in national legislation, such as direct negotiations or, in the case of unsolicited proposals, single source procurement. Direct negotiations are sometimes allowed under exceptional circumstances, such as when for special reasons competitive methods would not lead to satisfactory results, or in the case of projects with an anticipated initial investment value not exceeding a certain amount or of a limited duration.

20. Another issue which is sometimes dealt with in national legislation on privately-financed infrastructure projects concerns unsolicited proposals. Some laws refer to general criteria for the admissibility and negotiation of unsolicited proposals, but do not provide further details on the treatment to be given to such proposals and the procedures to be followed. Admissibility criteria may generally include national priority, uniqueness and cost considerations. Another approach to unsolicited proposals may be to provide specific procedures for handling them, for instance by providing criteria for the review of unsolicited proposals, followed by submission of the project to competitive selection with some form of incentive or preference to the originator of the unsolicited proposal.

C. Qualification requirements

21. It is proposed to deal in a section with those conditions that have to be met by all prospective candidates regardless of the methods for selection of the project sponsors elected by the host Government.

22. The first group of requirements to be dealt with concerns requirements such as the financial standing of the prospective project sponsors, or their legal status. Some laws require a minimum rate of equity investment, as a percentage of the total investment cost, or establish a ceiling for the availability of public funds to the project. Such minimum investment may be complemented by provisions requiring the project sponsors to submit proof of adequate capability to sustain the financing requirements for the engineering, construction and operational phases of the project. There may also be negative criteria, such as rules declaring certain persons or categories of persons or companies to be ineligible for participating in the selection process (e.g. persons who, in one or the other form, participate in acts related to awarding the project, or companies that, having previously carried out a similar activity, had their concessions withdrawn by the State). It is proposed to consider the desirability for the law to deal with those requirements directly or to refer this matter to the procuring entity.

23. The second group of requirements proposed to be discussed in the same section can be found in provisions establishing some sort of preferential treatment for domestic entities or affording special treatment to candidates that undertake to use national goods or employ local labour. Such preferential or special treatment may be provided as a condition for the selection of the project sponsors, as a criterion for the evaluation of offers, or as an obligation imposed on the project company. In some laws such preferential treatment takes the form of special evaluation criteria establishing margins of preference for national candidates, or candidates who offer to

procure supplies, services and products in the local market. Yet other laws do not expressly refer to the use of domestic supply sources as an evaluation criterion, but include it among other elements to be mandatorily or voluntarily included in the offers. Other laws provide that, all other things being equal, preference should be given to national candidates. It is important, where such preferences are established, to weigh the advantages expected from such domestic preferences against the particular needs of the project. It is also important to ensure transparency in the application of such domestic preferences as criteria for awarding the project.

D. Selection process

24. It is suggested that a section describe and analyse the legislative framework of a typical competitive selection process for infrastructure projects in two subsections, one dealing with provisions concerning prequalification criteria and one dealing with provisions governing the ensuing proceedings, including solicitation of tenders or request for proposals, content of tenders or proposals, feasibility and other studies, tender securities, evaluation of tenders or proposals, award of the project and dispute resolution.

25. The first issue proposed to be considered in the subsection dealing with prequalification of sponsors relates to the invitation to prequalify, its mode of circulation and content. As to the prequalification requirements, it is proposed to discuss matters such as requirements concerning the legal status of the project sponsors, as well as experience and past performance (which may cover aspects such as past performance of the sponsors with similar or related projects, experience of their key personnel, organizational and financial capability).

26. Provisions governing the steps that follow the prequalification of tenderers or proposers are suggested to be considered in the following subsection. It is desirable that instructions to prospective project sponsors indicate in detail the aspects to be covered by their tenders or proposals, including technical, financial and legal proposals. Particular importance is to be given to the studies, such as feasibility studies to be submitted with the tenders or proposals, which should normally address issues such as marketability, engineering design, economic, financial and operational feasibility of the project, as well as an environmental impact study. The importance for the host Government to conduct or obtain its own feasibility studies would also be discussed. Another aspect to be covered in the instructions issued by the host Government concerns the criteria to be applied for the evaluation of tenders or proposals. In general, it might not be desirable to burden the legislation with details of the selection process. However, to a certain degree national legislation may play an important role in providing guidance to the procuring entity with regard to all those aspects. Likewise, national legislation may establish an appropriate framework for the function of the procuring entity during the remaining phases of the selection process. The law may, for instance, authorize that the final submission of tenders or proposals be preceded by a conference in which the parties have an opportunity to clarify questions concerning the project, and as a result of which the host Government may amend or rectify the instructions, as appropriate. It is proposed to conclude this subsection with a discussion of final negotiations and award procedures, as well as of appropriate mechanisms for solving disputes relating to the award of the project.

V. PREPARATORY MEASURES

A. The site of the project
   1. Acquisition of land for the construction of the facility
   2. Rights of way and other easements
B. Establishment of the concessionaire
   1. The concessionaire as a consortium
   2. The concessionaire as an independent legal entity
C. Licences and approvals

Notes

27. It is proposed to discuss in chapter V a few important steps in the preparations for the implementation of the project: the acquisition of land for the construction of the facility, including access to the project site; the establishment of the consortium or company that will receive the concession to build and operate the infrastructure facility; the issuance of licences and approvals necessary for carrying out the project activities. It is suggested that chapter V consider the extent to which national legislation could adequately address those issues without depriving the parties of the flexibility necessary for meeting the needs of individual projects.

28. An initial draft of chapter V is contained in document A/CN.9/438/Add.3.

VI. THE PROJECT AGREEMENT

A. General considerations
B. The rights of the project company
   1. Property rights
   2. Exclusivity
C. General obligations of the project company
   1. Project execution and related obligations
   2. Guarantees of performance
   3. Liability and insurance
D. Subconcession, assignment and securities
   1. Subconcessions and assignment of the project
   2. Securities and encumbrances

Notes

A. General considerations

29. It is proposed to deal in one section with general considerations concerning the project agreement, discussing in particular the different approaches taken by national legislation concerning the project agreement (from those that scarcely refer to the project agreement to those that contain extensive mandatory provisions concerning clauses to be included in the agreement). Such a section would consider the possible advantages and limitations of existing approaches, taking into account the possibly varying need for legislative guidance on preparing a project agreement that may exist at different levels of Government (national, provincial or local). The remaining sections would deal with rights and obligations of the project company that, in addition

to being dealt with in the project agreement, might be usefully addressed in the legislation, as they might affect the interests of third parties.

B. The rights of the project company

30. It is proposed to deal with the nature of the rights and interests of the project company in the facility and related property, a question for which various solutions can be found. In some countries the law expressly provides that title to all assets originally furnished by the host Government for the construction of the facility, as well as all facilities and improvements built by the project company, is vested in the host Government throughout the duration of the agreement. Other laws, however, give the project company some type of property right and provide in detail its nature and scope. It might be desirable for the relevant legislation to clarify the nature of the property rights of the project company, an aspect that is of particular importance where the legislation allows the establishment of some sort of security interest in those assets and property. Also, where the legislation requires the transfer of the facilities to the host Government at the end of the concession period, questions might arise as to who holds title to improvements made to property originally received by the project company.

31. It is further proposed to deal in the same section with two other questions particularly important for project sponsors and lenders (but also relevant for the host Government and the users of the facility), namely whether the concession is exclusive and whether competing facilities will be allowed to operate. Project sponsors and lenders will be interested in obtaining assurances that the facility will generate sufficient revenue to repay the project company's debt, recoup the investment and allow them a reasonable profit. Thus, national laws often authorize the host Government to grant an exclusive right to the project company to pursue the activity that is the object of the concession. In some cases, the host Government undertakes not to provide public funding for parallel projects that might generate competition to the project company. However, such exclusivity is not always guaranteed by the law. In some cases, the host Government may reserve the right to grant multiple concessions in the same area, provided this is specified in the solicitation of tenders. In some cases, the host Government is authorized to grant concessions under a regime of "regulated exclusivity" where the operation of the facility by the project company is monitored by a regulatory body so as to ensure that it meets the interests of the public, an aspect to be considered in more detail in chapter IX, "Operational phase".

C. General obligations of the project company

32. The obligations of the project company concerning the construction and operation of the facility are provided in some national laws by a general reference to the project company's obligation to finance, build, operate and maintain the facility, while other national laws include more extensive lists of obligations such as to supply adequate service or to observe and ensure observance of rules and regulations relating thereto. Particularly with a view to the eventual transfer of the facility to the host Government, some laws require that the project agreement contain provisions on technology transfer and stipulate the manner in which local personnel designated by the host Government will be given adequate technical training.

33. The obligations of the project company are sometimes complemented by the provision of some form of guarantee of performance or insurance against the consequences of default. The

law may generally require that adequate guarantees of performance be provided by the project company and refer the matter to the project agreement for further details. Some laws, however, contain more detailed provisions, for instance requiring performance bonds up to a certain percentage of the basic investment to be presented by the project company at the time of project commencement. Different guarantees of performance may have to be provided for the construction and for the operational phases. The host Government may also wish to require a guarantee for the performance by other companies associated in the execution of the project or sufficient evidence that the project sponsors have raised funds or secured finance sufficient for the carrying out of the project. One aspect to be considered is that, depending on the terms of the performance bond, serious guarantors may not be able to issue a bond for the whole duration of the project. It is proposed that the *Guide* consider the possible implications of prescribing specific types of guarantees in the legislation, rather than leaving this matter to be addressed in the project agreement.

34. Another issue proposed to be dealt with in the same section relates to legislative provisions dealing with damage caused to third parties in the course of the execution of the project or the operation of the facility. The project company is normally liable for damages caused to the host Government, the users of the service or third parties which result from the project company's negligence. In some cases, such liability extends to liability for environmental damage. For the purpose of ensuring that the project company will meet its liability, some laws require that the project company purchase and maintain adequate insurance, including workmen's compensation insurance, while other laws establish an option of self-insurance against specific forms of liability, subject to approval by the host Government, in the event no insurance is available at a reasonable cost in the national or international insurance markets.

D. Subconcession, assignment and securities

35. It is proposed that a section discuss the questions of subconcession, assignment of the project company's rights and security interests established to the benefit of the project company's creditors.

36. In cases where the project company is given the right to provide ancillary services, or where the concession involves multiple activities capable of being carried out separately, the project company may wish to engage another entity to carry out some of those activities. Some laws require that the project agreement prohibit a subconcession or any arrangement to that effect, in whole or in part, without prior approval of the host Government. A different approach can be found in national laws which, while still requiring prior approval by the host Government, authorize subconcessions provided that the subconcession is awarded through a competitive method and the subconcessionaire assumes all the rights and obligations of the concessionaire within the scope of the subconcession.

37. During the life of the project, it may happen that third parties become interested in substituting for the project company. Also, situations may arise where, due to the failure or inability of the project company to perform its obligations, it might be in the interest of the parties to allow the project to continue under the responsibility of another company or consortium. This may be done by means of an assignment of the concession to a third party.

Few laws prohibit categorically any assignment of the concession, while other laws authorize such an assignment, subject to approval by the host Government, which may also be required for a transfer of the right to control the project company. The lenders, whose main or sole recourse is the revenue generated by the project, may have an interest in ensuring that the works will not be left incomplete and that the concession will be operated profitably in the case of inability of the project company to do so. In some cases, the law recognizes such an interest and provides that under certain circumstances the lenders may have an option to appoint a new project company to substitute for the initial project company, subject to approval by the host Government.

38. One essential factor for obtaining financing for the project is the ability of the project company to offer acceptable security interests to the lenders, such as mortgages or assignment of receivables generated by the project. Some laws expressly recognize that interest by allowing the project company to create a security interest over the concession, the rights arising from the concession or the property involved, with the consent of the host Government. Some laws specifically authorize the establishment of mortgages or other security interests in the project's property, provided that such property continues to be used for the purposes of the concession. Some laws, however, strictly prohibit the establishment of any encumbrance on the concession or the rights related to it, or provide that the concession agreement may contain such a prohibition. It is proposed to discuss the possible implications of those approaches.

VII. GOVERNMENT SUPPORT

A. Financial support
   1. Sovereign guarantees
   2. Loans and revenue assurances

B. Incentives, facilities and benefits
   1. Taxation and customs
   2. Ancillary revenue sources
   3. Other assurances and facilities

Notes

A. Financial support

39. The proposed topic for the opening section of chapter VII relates to financial measures that may be taken by the host Government for the purpose of reducing the commercial, financial, political or other risks faced by the project company and the lenders. One of the host Government's motivations for pursuing privately-financed infrastructure projects is often to limit the commitment of public funds, a motivation which is reflected in those laws that provide that the concessionaire alone is responsible for the financial viability of the project with no guarantees being given by the host Government. Other laws, in turn, with a view to encouraging private investment, authorize the host Government to share the project risks by contemplating some form of financial support by the host Government, in the form of guarantees or loans, without which the project might not materialize. It is proposed to consider the desirability of allowing some flexibility for the host Government in devising the level of support it may provide to the implementation of the project. For that purpose, it is suggested to examine types of support that are sometimes contemplated in national legislation, and which in some countries might require special legislative authorization.

40. Guarantees contemplated in national laws may include: foreign exchange guarantees such as the guarantee that the revenue generated by the facility may be converted into foreign currencies, for the purposes of repaying loan capital and interest, paying expenditures requiring foreign currency, or paying to foreign investors their share of profits; guarantees of payment of goods and services supplied by the project company when the goods or services are supplied to the host Government or a public entity; loan guarantees concerning the repayment of loans taken by the project company. Since the project company's ability to repay loans is essentially predicated upon the revenue generated by the project, a governmental guarantee of repayment of loans might assure the lenders and the project company that they would not be unreasonably exposed in the case of early termination of the agreement or other unforeseeable changes of circumstances or emergency situations outside the control of the project company that render the project company temporarily unable to operate the project or meet its financial obligations. Some forms of guarantees provided by the host Government may be supported by a guarantee issued by international financial institutions, such as the World Bank. Some of those institutions may give guarantees or provide insurance coverage against a number of risks directly to the benefit of the private sector.

41. In addition to guarantees, in some cases the host Government, directly or through a governmental agency, may itself extend certain loans to the project company for specific purposes, such as to cover possible loss or damage caused by the host Government or due to *force majeure* events, or to finance modifications of the project agreement. Such loans may require the provision of some collateral by the project company, such as a mortgage of real estate provided to the project company for the development of the project. The provision of such loans, like loan guarantees, might be a way for the host Government to share the project risks without an up-front commitment of public funds. From the perspective of lenders and sponsors, such risk-sharing might be significant for reducing or limiting their exposure to loss that results from unilateral acts of the host Government or other events beyond the control of the project company.

42. Another type of financial support may be an assurance by the host Government of a minimum revenue to the project company. When the Government or a governmental entity is the sole customer for the services or goods supplied by the concessionaire, the law sometimes provides that the Government or some governmental entity will be under an obligation to purchase such goods and services, at an agreed rate, as they are offered by the concessionaire. With regard to services provided directly to the public, the host Government sometimes undertakes to subsidize the project company, in the event that officially approved tariffs fall below the level provided in the project agreement. In other cases, the project company is paid a flat or variable sum directly by the host Government, on the basis of an estimated number of paying users of the facility arrived at in the course of the selection process.

B. Incentives, facilities and benefits

43. It is proposed to deal in a separate section with other forms of support that are often provided to privately-financed infrastructure projects. The host Government may grant some form of tax and customs exemption, reduction or benefit to the project company (e.g. to facilitate the import of equipment for the use of the project company by means of exemption of customs duties), or may establish some preferential tax treatment. Sometimes the law authorizes the host Government either to grant an exemption from customs duty or to guarantee that their level will not be raised to the detriment of the project.

44. One form of reducing the commercial risk to which the project company is exposed may consist in offering the possibility of additional concessions for the provision of ancillary services or the exploitation of other activities. By giving the project company alternative sources of revenue the host Government could make it possible for the project company to follow a policy of low or controlled prices for the main service. Thus, some laws authorize the host Government to provide in the solicitation of tenders that the concessionaire will be given the possibility of other revenue sources from alternative, complementary or ancillary projects, with or without exclusivity, with a view to encouraging low tariffs. The law sometimes provides that the host Government may grant the project company the right to use property belonging to the host Government for the purposes of such activities (e.g. land adjacent to a highway for construction of service areas).

45. Additional assurances and facilities that may be provided by the host Government to the project company may include the provision of various forms of insurance coverage to the project

company or its employees, or an assurance that the project company will be provided with, or will have facilitated access to, supplies, goods and facilities which are needed for the operation of the infrastructure facility.

VIII. CONSTRUCTION PHASE

A. Contractors of the project company
   1. Award procedures
   2. Contractual regime

B. Project development
   1. Monitoring of project development
   2. Acceptance and final approval

Notes

A. Contractors of the project company

46. Given the complexity of infrastructure projects, the project company is likely to retain one or more contractors for performing the works under the project agreement. It is proposed that a section of chapter VIII deal with the procedures for selecting those contractors and with the laws governing their contracts with the project company.

47. Two basic approaches have been used for dealing with the selection of the contractors of the project company. Some laws require the project company to identify in its tender or proposal the contractors that will be retained, including information on their technical capability and financial standing; other laws only require prospective project sponsors to indicate the percentage, if any, of the total value of the work which they intend to assign to third parties. There are also laws that require the project company to observe essentially the same procedures for selecting its contractors as were applied to the selection of the project company itself, an obligation which may also extend to the subcontractors of the contractors.

48. The group of project sponsors often includes engineering and construction companies, which participate in the selection process in the expectation that they will be given the main contracts for the execution of the construction and other works. Those companies might be reluctant to join the other project sponsors if they had no assurance of being awarded those contracts. One possible solution might be to have a rule similar to the procurement rules of some international financial institutions, which provide that, where the project company was selected under a competitive method acceptable to such financial institutions, the project company is free to use its own procedures to procure goods, works and services required for the facility. However, where the project company itself was not selected through a competitive method acceptable to such financial institutions, the goods, works and services required for the facility have to be procured through a competitive method.

49. It is common for the project company and its contractors to choose a law that is familiar to them and that in their view adequately governs the issues addressed in their contracts. Prospective project sponsors would not normally be inclined to subject their contracts to a legal

system that is unknown to them and might, therefore, be reluctant to participate in a project if the laws of the host country subject all their contracts to its national law, or require the approval of the host Government for the application of foreign law. In most cases, however, Governments have found no compelling reason for making provisions on the law applicable to the contracts between the project company and its contractors, and have preferred to leave this question to a choice of law clause or to the rules on conflict of laws. In some cases, provisions have been included for the purpose of clarifying, as appropriate, that the contracts entered into between the project company and its contractors are exclusively governed by private law, that the contractors are not agents of the host Government, and that, accordingly, the host Government has no liability for the acts of the contractors or no obligation to pay compensation for work-related illness, injury or death to those contractors' employees.

B. Project development

50. In section B of chapter VIII it is proposed to discuss legal issues relating to the development of the project, including procedures for monitoring the progress of the construction works and for the final acceptance of the infrastructure facility.

51. National laws often contain provisions concerning the development of the project and the procedures to ensure compliance by the project company with the engineering design and technical specifications. The initial construction project may be subject to review by the host Government so as to ensure that it conforms to the specifications and technical requirements for the development of the project. For the purpose of avoiding delay in the commencement of the construction, the law may establish deadlines for the approval of the construction project by the host Government and provide that the approval is deemed to be granted if no objections are made by the host Government within a certain period. Should the host Government find that the construction project deviates from the specifications, the law sometimes expressly provides that the host Government will have the right to request modifications in the project, and clarifies that the host Government will not be liable for delays that result from the need to make such modifications. In some cases, in addition to setting a deadline for the review of the construction project by the host Government, the law may expressly limit the grounds on which the host Government may raise objections to the project and establish rules for solving disagreements.

52. Following approval of the construction project, the law often provides for continued monitoring by the host Government throughout the construction phase. The law may deal with the execution of the project in several stages, in accordance with the time-table provided in the project agreement, and require governmental approval for the formal completion of each stage. For the purpose of facilitating the liaison between the host Government and the project company, the law sometimes requires the host Government to designate one officer to exercise all monitoring functions provided in the law, or indicate which governmental organ is to do so. In some projects it was found useful to require the project company to appoint an independent project manager, through whom all communications with the relevant governmental entity would be channelled.

53. When the works performed by the project company are found to be unsatisfactory or inconsistent with the specifications, the law sometimes provides that the project company may be

subject to penalties or liquidated damages as provided in the project agreement. It is proposed to discuss this matter in chapter X, "Performance issues".

54. Upon completion of construction, some laws provide for a final inspection and approval of the works by the host Government, as a condition for authorizing the project company to operate the facility. The law may also authorize a provisional operation of the facility, pending final acceptance by the host Government. The final inspection of the facility sometimes includes the testing, as required, of any equipment installed by the project company, so as to ensure that it is in proper operating condition, providing an opportunity for the project company to cure defects that might be found at that juncture. In respect of facilities to be used by the public, provisions of this kind may be of great importance for the host Government, particularly in those countries where the State would have a direct or residual liability to the public for damage or injury attributable to defects in the construction of the facility. In the case of other facilities closed to the public and normally accessible only by the project company and its personnel, the public interest may be less prominent, and the host Government may satisfy itself with requiring the project company to undertake those tests, subject to the general monitoring rights of the host Government.

IX. OPERATIONAL PHASE

A. General regulatory considerations
B. Conditions of operation
   1. Scope and quality of services
   2. Price and price increases
   3. Relations with users
C. Inspections and monitoring
   1. General inspection measures
   2. Special monitoring powers

Notes

A. General regulatory considerations

55. It is proposed to deal in the opening section of chapter IX with general regulatory issues concerning the operation of the infrastructure facility by the project company. In pursuing private-sector participation in infrastructure, Governments usually expect to achieve efficiency gains and high standards of service, which sometimes may not be provided by self-regulated State monopolies. Where multiple concessions are awarded for the same sector, the host Government may expect that the competition among the concessionaires will have a certain regulatory effect and will be conducive to achieving efficiency and quality targets. However, Governments may find that the market cannot always be relied upon for solving issues relating to the operation of the infrastructure facility in a manner that satisfies the public interests, so that some form of external regulation might still be necessary. Even greater might be the need for such external regulation in the case of exclusive concessions where a natural monopoly takes the place of a State monopoly.

56. In some cases, the host Government may attempt to address all regulatory issues (e.g. quality of services, level of tariffs) in the project agreement or in the pertinent legislation, an approach which may not always be adequate to the long-term nature of privately-financed infrastructure projects. In other cases, the project company might be given great freedom to establish its own commercial and pricing policies, a solution which some Governments might be reluctant to adopt. Governments that wish to reserve for themselves the possibility of regulating the operation of the infrastructure facility sometimes give such power to the same authority that awarded the concession. Other Governments, however, may prefer to establish another body for that particular purpose and give such body certain latitude in the exercise of its functions. However the mechanism is conceived, Governments might find it useful to provide a certain level of legislative guidance for the exercise of such regulatory functions.

B. Conditions of operation

57. After the above general regulatory considerations, it is proposed to deal in a separate section with three basic issues relating to the conditions of operation of the infrastructure facility: the scope and quality of the services provided by the project company, the establishment and adjustment of the price charged by the project company, and the relations of the project company with the purchasers of the goods or services or the users of the facility.

58. The law may sometimes mention in general terms the scope of the services to be provided by the project company, particularly those laws governing one particular sector or service. Sometimes the scope of the services and the manner in which they have to be provided may be subject to rules issued by the competent regulatory body, or rules issued by the project company, with that body's approval. In addition to general rules concerning the scope of the services, some laws provide criteria for assessing the quality of the services to be provided by the project company as well as general definitions of applicable standards of quality. Another approach is to leave this matter to the project agreement.

59. Although recognizing that the terms of the concession are subject to the agreement of the parties, in some legal systems the host Government has the right to change the scope and characteristics of the services to be provided by the project company for reasons of public interest, subject to compensation for financial loss or additional costs that result for the project company from such unilateral changes by the host Government.

60. As regards the prices charged by the project company, two basic approaches have been observed: in some cases the project company is free to determine its pricing and commercial policy, while in other cases the law subjects the initial price charged by the project company to some control mechanism (e.g. approval by the competent regulatory body, or requirement that the prices be provided in the project agreement). The competent regulatory body may have to approve criteria and parameters to be followed for determining reasonable price levels that allow the project company to recover the investment and achieve a reasonable rate of return. In some cases, the law itself may provide the method for determining the prices to be charged by the project company.

61. In addition to making provision for determining the initial prices, national laws may provide rules governing the adjustment of those prices during the term of the agreement. The

proposed tariff level is often an important, if not decisive factor in the selection of the project sponsors. Thus, the host Government may have an interest in establishing reasonable limits for increase of tariffs so as to discourage prospective project sponsors from submitting unrealistically low proposals in the expectation of being able to raise the tariffs at a later stage. Criteria and parameters for price adjustments are sometimes indicated in the law, as in the case of official price indices. In addition to variations in official price indices, some laws provide that the competent regulatory body will authorize price adjustments when the costs of the project company rise as a result of an act of the host Government including changes in taxation subsequent to the project agreement. For the purpose of devising appropriate mechanisms for price adjustments, it is desirable that the host Government bear in mind the expectations of other parties involved. For instance, the lenders might need a pre-determined formula for price adjustments in order to estimate the revenue of the project. Thus, the lenders might wish to have such formula reflected in the project agreement, or some other document of general application, rather than being subject to the sole discretion of a regulatory body. Therefore, when a regulatory body is given the authority to approve parameters or conditions for price increase, the lenders might find some comfort in that the guidelines for the exercise of such authority are provided by the law. Another related issue is the extent to which, in the interest of the project, the law may exempt the project company from specific legislation relating to price and tariff control or providing special treatment in favour of certain categories of users.

62. Where the project company provides a service directly to the public, the law sometimes contains provisions regulating their relations or spelling out the rights and obligations of the users of the service concerned. The project company is often required to provide the service without discriminating against any group of users, except for differences based on objective considerations, such as the technical characteristics and the specific costs resulting from providing the service for different categories of users. In some cases, the project company may be required to enter into contracts with the users of the service or the consumers of the goods supplied by the project company (such as gas, water or electricity). Depending on the nature of those goods or services, the law may establish a chain of legal arrangements, each governed by a different contract, such as between energy producer and transporter, energy transporter and energy distributor and energy distributor and consumer.

63. In some cases, the project company is required to establish procedures for dealing with complaints and claims by the users of the service. In other cases, the law entrusts the competent regulatory body or other governmental agency with the responsibility of protecting the interests of the users of the service and guaranteeing their right to file complaints with such agency.

C. Inspections and monitoring

64. Given the importance of infrastructure projects for the host Government, and the Government's ultimate accountability for the quality of services provided to the public, the host Government is likely to retain the right to monitor the operation of the facility. Possible legislative approaches vary from laws which appoint officers to carry out inspections, specify the powers given to them and describe in detail the procedures for such inspection, to those laws that only refer to such inspection and monitoring powers in general terms and require that the relevant procedures be provided in the project agreement. Furthermore, the project company may be

required to report regularly to the competent regulatory body on the operation of the facility or to submit special reports upon request. The consequences for the project company of a breach of its contractual or statutory obligations may include fines or other pecuniary sanctions, as provided in the law, an issue which is proposed to be considered in chapter X, "Performance issues". In general, however, the exercise by the host Government of such monitoring functions does not relieve the project company of its own liability for damage sustained by the host Government, users or third parties as a result of the breach of its obligations.

65. It is generally desirable that inspections and control measures be carried out in such a manner so as to cause the least possible disturbance to the operation of the facility or to avoid unreasonable intervention in its operation. With regard to the cost of inspection and related measures, some laws provide that the project company may be required to bear such costs, as determined by the host Government, whereas other laws refer this matter to the project agreement.

66. In addition to general inspection powers, some national laws authorize the host Government to assume control over, and temporarily administer, the facility for reasons of public interest. In some countries, the powers of the officer responsible for the temporary administration are set out in the law and generally do not include disposing of assets, or requesting the termination of the concession. With a view to reassuring prospective project sponsors and lenders that such powers will not be arbitrarily or unreasonably exercised, the law may spell out those exceptional circumstances which may authorize the host Government to appoint a temporary administrator (see also above, para. 37).

X. PERFORMANCE ISSUES

A. Delays, defects and other failures to perform
   1. Definition of failure to perform
   2. Failure during the construction phase and during the operational phase
B. Exemption provisions
   1. Definition of exempting events
   2. Consequences for the parties
C. Change of circumstances
   1. Acts of the Government
   2. Hardship provisions

Notes

A. Delays, defects and other failures to perform

67. It is proposed to deal in a section with performance failures by the project company, an issue to which different approaches have been used in national laws. In some countries the legislation does not contain specific provisions on this matter, which is left for the project agreement. Other laws, however, contain generally worded provisions defining breach of contract by the project company and providing remedies, which constitute a general framework for more detailed provisions in the project agreement or in specific regulations. In making provisions on this issue, it might be desirable to distinguish, as some laws do, between failures that occur during the construction phase and failures in the operation of the facility by the project company.

68. The project company may be required to take a number of measures before the execution of the project (e.g. to secure the necessary financial means; to prepare the technical documentation; to sign the project agreement within a certain period from the award of the concession; to establish the project company; to obtain licences or permits). Remedies available to the host Government in the event of failure by the project company to meet those conditions may take different forms, including, for particularly important conditions, the termination of the project agreement. In those cases, it might be desirable to provide that the host Government will give written notice to the project company to meet pending conditions, prior to terminating the project agreement. With regard, in particular, to termination for failure to obtain licences, it might be further desirable to specify that no termination would take place when the failure is not attributable to the project company's fault. Such a provision might reassure lenders and sponsors that they would not be penalized, for instance, by inaction or error on the part of the host Government or its agents.

69. During the construction phase, performance failures might relate to two broad categories: delay in construction and defective construction. Remedies available for failures at that stage may include payment under guarantees provided by the project company, payment of liquidated damages or penalties, or fines. Generally, it might be sufficient for the law to require that the project agreement contain provisions on this matter, rather than to establish a scheme of remedies

applicable to all types of projects. In most situations, it might be advisable to treat the termination of the project agreement and withdrawal of the concession as last resort measures to be used only in case of particularly serious or repeated failures, or when it can no longer be reasonably expected that the project company will be able or willing to complete the work or cure the defects. In some countries, special procedures apply for establishing the failure of the project company prior to resorting to contractual remedies. Both the host Government and the lenders will be interested in ensuring that the construction of the facility is completed. Thus, in some cases, rather than terminating the agreement and assuming the responsibility for, and the cost of, the completion of the facility, the host Government might wish to give the lenders the opportunity to appoint a substitute company, acceptable to the host Government, to complete the unfinished infrastructure facility and bring it into operation (see above, para. 37).

70. Also, during the operation of the facility, it might be desirable for the law to give the parties the possibility of establishing a hierarchy of remedies available to the host Government, according to the seriousness and repercussions of the failure by the project company, which might be accompanied by provisions prescribing the procedures for establishing performance failure and resorting to available remedies. In some legal systems, the host Government has the right to take over temporarily the operation of the facility, normally in the case of serious failure to perform by the project company. Some laws may provide that certain events justify the withdrawal of the concession. Here, too, it might be desirable to limit the withdrawal of the concession during its operation to particularly serious circumstances.

B. Exemption provisions

71. In drafting national legislation, it is desirable to take into account events that might preclude the project company, temporarily or permanently, from performing its contractual obligations and that are often referred to by expressions such as "*force majeure*" and other terms with similar meaning. Such impediments may be the consequence of natural phenomena, such as fire, storms or flood, or of human actions, such as war, riots or revolts. The occurrence of an exempting event may sometimes justify the suspension of the project execution or the operation of the concession for the duration of the impediment subject to a maximum period of suspension. Whether or not the project company will be entitled to claim compensation from the host Government or whether the host Government will share some of the costs entailed by the suspension of the project are questions to which national laws provide different answers. A procedure for determining, in a given case, whether an event falls within the category of *force majeure* is sometimes spelled out in the law.

C. Change of circumstances

72. Some laws deal with the rights of the project company in the event the execution of the project is prevented by an act of the host Government. In some cases, the relevant rules contain a general undertaking by the host Government not to interfere with the execution of the project, except under special circumstances. In other legal systems, however, the host Government usually has the right to alter the terms of a concession when the public interest so requires, subject to compensation to the concessionaire. If the execution of the project is interrupted as a consequence of a governmental act, the project company may be entitled to an extension of the concession period as well as compensation for the damage it sustained. While in some cases it

might be impliedly understood that the host Government will be responsible to pay such compensation, it might be advisable to include a specific provision in the legislation to that effect, so as to reassure the project company that it would not have to bear additional costs as a result of governmental acts which were not prompted by any failure on its part.

73. Another related matter concerns changes in factors that, without preventing the performance of contractual obligations, render the performance by the project company considerably more onerous than foreseen at the time those obligations were assumed. Some legal systems have special rules dealing with such situations, which allow a revision of the terms of the project agreement so as to restore its original economic equilibrium. In some cases, the possibility of a revision of the terms of the agreement is generally implied in all governmental contracts, or is expressly provided for in legislation. Some laws on privately-financed infrastructure projects generally recognize the possibility of such changes of circumstances but refer the matter to the project agreement for concrete solutions.

XI. EXPIRY, EXTENSION AND EARLY TERMINATION OF THE PROJECT AGREEMENT

A. Expiry of the project agreement
   1. Term of the project agreement
   2. Transfer of the facility and related measures
B. Extension of the project agreement
C. Early termination of the project agreement
   1. Grounds for early termination
   2. Consequences for the parties

Notes

A. Expiry of the project agreement

74. It is suggested to discuss the expiry, extension and early termination of the project agreement, dealing first with the consequences of the expiry of the term of the project agreement and the transfer of the project to the host Government at the end of the project period.

75. Many national laws limit the duration of the concession to a maximum number of years, which sometimes expressly include the construction period, as well as any extension given for reasons of *force majeure*. The rationale for including the construction period in the total concession period is to encourage the project company to complete the construction works ahead of schedule, so as to benefit from a longer period of concession. In some cases, however, Governments have preferred to establish a combined system whereby the project agreement ends once the debts of the project company have been fully repaid and a certain revenue, production or usage level has been achieved, subject to a maximum limit of a fixed number of years.

76. In a typical "build-operate-transfer" project, the infrastructure facility is normally transferred to the host Government at the end of the concession period. Some laws expressly provide that the assets to be transferred include not only those originally provided to the project

company, but also those assets, goods and property subsequently acquired by it for the purpose of operating the facility, while other laws leave this question to be clarified in the solicitation of tenders or in the project agreement. Some laws specifically provide that, upon termination of the concession, the host Government will compensate the project company for the cost of those improvements made upon the original property for the purposes of ensuring the continuity of the service which at that time have not yet been recovered by the project company. The host Government in those cases has the right to receive the assets and property related to the concession in good and operating condition. For that purpose, the project company may be required to provide some sort of financial guarantee. In some cases a special inspection of the facility takes place prior to the termination of the concession, as a result of which the host Government may require additional maintenance measures by the project company so as to ensure that the facility is in proper condition at the time of the transfer. In some cases, the law provides that guarantees given by the project company will have to be extended until the facility is received by the host Government to its satisfaction, and that the host Government may draw on such guarantees to pay the repair cost of damaged assets or property.

B. Extension of the project agreement

77. In the second section of chapter XI it is proposed to consider the possibility of an extension of the project agreement, an issue on which different solutions are found in national laws. Some laws authorize one or more extensions of the concession period for an equal or shorter term, while other laws generally prohibit extensions, save for exceptional conditions, such as to allow the project company to recover the cost of extraordinary work required to be done on the facility.

78. Limitations on the extension of the concession period are sometimes provided as a protection for the host Government against demands by the project company. In some cases, with a view to encouraging competition in the sector concerned, the law requires the host Government to submit the concession, upon its expiration, to public tendering, in which case the project company may be given a margin of preference over other equally qualified candidates.

C. Early termination

79. It is suggested to discuss in a separate section the events or circumstances that cause or justify the early termination of the project agreement and the consequences that derive therefrom for the parties.

80. Main grounds for early termination normally include any of the following: the opening of certain types of insolvency proceedings in respect of the project company; the expropriation of the project company; the termination for reasons of public interest; the inability or serious failure by the project company to perform its obligations; or the failure by the host Government to perform its obligations.

81. The expropriation of the concession, or its take-over by the host Government for reasons of public interest, is typically subject to a special procedure and payment of appropriate compensation. A few laws expressly give the project company the right to terminate the agreement in the event of default or failure by the host Government to perform its obligations.

82. In the event of insolvency, failure or inability of the project company to continue to provide the service, it may be in the interest of the host Government to make provisions to avoid the interruption of the service. The law may provide that, in such cases, the host Government may appoint a temporary administrator so as to ensure the continued provision of the relevant service, or give the lenders the right to substitute for the project company, or appoint a substitute. Some laws provide for the continuation of such temporary administration until the creditors admitted to the insolvency proceedings decide, upon recommendation by the insolvency administrator, whether the activity will be pursued or whether the right to exploit the concession will be put to auction. In some cases, the law excludes the assets and property related to the concession from liquidation or insolvency proceedings, or requires prior governmental approval for any act of disposition by a liquidator or insolvency administrator (see also above, para. 66).

83. Unlike early termination as a sanction for the project company's failure to perform its obligations, an early termination for reasons of public interest is not normally attributable to acts of the project company, a distinction which may be taken into account by the law when determining the compensation to be paid to the project company in each case.

XII. GOVERNING LAW

Notes

84. It is proposed to deal in a chapter with the issue of the law applicable to privately-financed infrastructure projects and the possible implications of different laws applying to different aspects of the project.

85. Some national laws on privately-financed infrastructure projects contain provisions on the law that applies to the project agreement between the host Government and the project company, often mandating the application of national law. Depending on whether the legal regime of the concession is regarded as a contract or as an act of Government (a question to be addressed in chapter III, "General legislative considerations" and chapter VI, "The project agreement"), the law might give preference to either private or administrative law. In the latter case, a different approach is taken by those laws that provide for the subsidiary application of administrative law only, or that establish a hierarchy of legal provisions applying to the project. In general, it might be desirable to clarify in the law whether and to what extent the project agreement may deviate from, or supplement, the provisions of such legislation.

86. In some countries, the law governing privately-financed infrastructure projects does not contain a specific provision on the extent to which the project agreement may be subject to a law other than the law of the host Government. Another approach used has been to list the areas in which the law of the host country is to apply (e.g. transfer of technology, accounting, labour relations, foreign exchange control) and to provide that in respect of issues not governed by the laws of the host country, the project agreement may be made subject to a foreign law.

87. The law applicable to the contracts entered into by the project company with entities other than the host Government varies. Loan agreements will be often subject to the laws of a jurisdiction chosen by the parties. Agreements among the project sponsors may also be subject to

foreign law. In turn, the contracts between the project company and its local customers and users of the facility, or with its local employees, suppliers or other commercial partners, are often subject to the laws of the host country. It is important for the parties to consider carefully the enforceability in the host country of rights created or obligations assumed in other jurisdictions. At the same time, it might be advisable for the host Government to review pertinent provisions of national law in the light of the commitments that the project company is required to make for obtaining the financial and other means necessary for the implementation of the project.

XIII. SETTLEMENT OF DISPUTES

Notes

88. It is proposed to deal in a section with the legislative framework for the settlement of disputes that might arise in connection with a privately-financed infrastructure project.

89. Disputes between the project company and foreign contractors, or between the host Government and the project company, are frequently of a commercial nature and it has often been agreed to subject those disputes to arbitration. An appropriate legal framework for the settlement of those disputes may be provided by means of special legislation, based on internationally accepted standards, governing international commercial arbitration and reflecting particular needs of international arbitration. A particularly suitable model for such legislation is the UNCITRAL Model Law on International Commercial Arbitration.

90. It should be noted, however, that there might be limits to the availability of arbitration for disputes between the project company and the host Government under some legal systems, such as in those countries where disputes involving the Government come mandatorily under the jurisdiction of the national courts.

91. In view of the potentially large and complex disputes that may arise out of a privately-financed infrastructure project, it might be desirable for the law to enable the parties to devise mechanisms for dealing with divergencies as they arise and for avoiding their escalation into open litigation. In some cases, the parties found it useful to establish expert panels, with varying composition according to the nature of the issues at stake, which make recommendations to the parties for the settlement of their disputes. The implementation of the project might experience difficulties if even minor disagreements or disputes over technical issues needed to be submitted to lengthy proceedings for lack of an express legislative authorization for a mechanism to settle those disputes at an early stage.

92. Another category of disputes which may be of concern for the host Government are the disputes between the project company and its customers. The project company may be authorized, or in some cases required, to establish dispute settlement mechanisms. The extent to which such mechanisms may displace the jurisdiction of national courts depends on the laws of each country.

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PRIVATELY-FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately-financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter I. SCOPE, PURPOSE AND TERMINOLOGY OF THE GUIDE

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A. Transactions covered by the *Guide*

1. Privately-financed infrastructure projects are transactions pursuant to which the national, provincial or local Government engages a private entity to develop, maintain and operate an infrastructure facility in exchange for the right to charge a price, either to the public or to the Government, for the use of the facility or the services or goods it generates.

2. The transactions covered by the *Guide* may be used for the private financing of various types of facilities, including, for example, power-generation plants, facilities for treatment of waste water or supply of potable water, toll roads, railways, airports, telecommunication networks. Generally, the transactions covered by the *Guide* relate to infrastructure facilities that are destined to be used by the public or that generate some form of commodity or provide some form of service to the public. Not covered in the *Guide* are transactions for the "privatization" of State property or functions by means of the sale of State property or shares of State-owned entities to the private sector. Furthermore, the *Guide* does not cover transactions for the exploitation of natural resources, such as oil or mining "concessions" or "licences".

B. Purpose of the *Guide*

3. The purpose of the *Guide* is to assist national Governments and legislative bodies in reviewing the adequacy of laws, regulations, decrees and similar legislative texts relating to transactions for the private financing, construction and operation of public infrastructure facilities.

4. The *Guide* sets out a number of issues often addressed in national laws and regulations pertaining to privately-financed infrastructure projects, which were taken into account in the preparation of the *Guide*. The *Guide* discusses the desirability of dealing with those issues in legislation and offers examples, as appropriate, of possible legislative solutions on certain issues. The thrust of the advice provided in the *Guide* is to achieve an appropriate balance between the need to attract private investment for infrastructure projects and the need to protect the interests of the host Government or the users of the infrastructure facility. The *Guide* does not provide a single set of model solutions for the issues considered, but helps the reader to evaluate different approaches available and to choose the one suitable in the national context.

C. Terminology used in the *Guide*

5. The following paragraphs explain the meaning and use of certain expressions that appear frequently in the *Guide* or which are often used in national laws or writings in connection with privately-financed infrastructure projects. For terms not mentioned below, such as terms of art used in financial and business management writings, the reader is advised to consult other sources of information on this subject, such as the *Guidelines on Infrastructure Development through*

Build-Operate-Transfer (BOT) Projects prepared by the United Nations Industrial Development Organization (UNIDO).1/

1. Build-operate-transfer (BOT) and related expressions

6. A public infrastructure project is said to be a "build-operate-transfer" (BOT) project when the host Government selects a private entity to finance and construct an infrastructure facility and gives the entity the right to operate the facility commercially for a certain period, at the end of which the facility is transferred to the Government. Usually the host Government holds title to the facility and the land on which it is built. However, the parties may provide that the private entity will own the facility until it is transferred to the host Government, in which case the project is referred to as a "build-own-operate-transfer" (BOOT) project.

7. One variation of BOT projects are the "build-rent-operate-transfer" (BROT) projects or "build-lease-operate-transfer" (BLOT) projects, where, in addition to the obligations and other terms usual to BOT projects, the private entity rents the physical assets on which the facility is located for the duration of the agreement. In some projects, such as the "build-transfer-operate" (BTO) projects, it is expressly provided that the infrastructure facility becomes the property of the host Government immediately upon its completion, the project company being awarded the right to operate the facility for a certain period.

8. "Build-own-operate" (BOO) are projects in which, as in BOOT projects, a private entity is engaged for the financing, construction, operation and maintenance of a given infrastructure facility in exchange for the right to collect fees and other charges from its users. However, under this arrangement the private entity permanently owns the facility and its assets and is not under an obligation to transfer them back to the host Government.

9. A similar arrangement is the "design-build-finance-operate"(DBFO) modality, which also entails ownership of the infrastructure facility by the private sector, and in which the private sector assumes the additional responsibility for the design of the facility.

10. There are also arrangements whereby existing infrastructure facilities are turned over to private entities for being modernized or refurbished, operated and maintained, permanently or for a given period time. Depending on whether the private sector will own such infrastructure facility, those arrangements are called either "refurbish-operate-transfer" (ROT) or "modernize-operate-transfer"(MOT), in the first case; or "refurbish-own-operate" (ROO) or "modernize-own-operate"(MOO) in the latter case.

11. Sometimes all of the above transactions and other possible forms of privately-financed infrastructure projects are generally referred to with the acronym "BOT". In the *Guide,*

1/ United Nations Industrial Development Organization, *Guidelines for Infrastructure Development through Build-Operate-Transfer (BOT) Projects*, Vienna, 1996. (UNIDO Sales Publication No. UNIDO.95.6.E) (hereafter referred to as the *"UNIDO BOT Guidelines"*).

however, the term "BOT" is only used in reference to the particular type of privately-financed infrastructure projects described in paragraph 6.

2. "Project agreement" and related words

12. As used in the *Guide*, the words "project agreement" mean an agreement between the host Government and the private entity or entities selected by the host Government to carry out the project, and which sets forth the terms and conditions for the construction or modernization, operation and maintenance of a public infrastructure facility.

13. The expression "project sponsors" refers to the group of companies that submit a joint proposal or tender for the development of an infrastructure project and agree to carry it out jointly if awarded the project by the host Government.

14. The words "project consortium" are used in the *Guide* in a narrow sense to refer to an unincorporated joint venture created by the project sponsors for the specific purpose of carrying out the project, when the laws of the host country do not require the establishment of an independent legal entity for that specific purpose (see chapter V, "Preparatory measures", paras. 29-37). The words "project company" are used to refer to the independent legal entity established by the project sponsors for the purpose of carrying out the construction works and operating the infrastructure facility.

3. "Concession" and related terms

15. When some writings or legislative texts refer to privately-financed infrastructure projects, they may use expressions such as "concession", "franchise", "licence" or "authorization". In some national laws, particularly those pertaining to the civil law tradition, certain forms of privately-financed infrastructure projects are referred to by well-defined legal concepts such as "public works concession" or "public service concession". These concepts are governed by elaborate provisions that are part of a specific body of law, typically referred to by expressions such as "administrative law". In other national laws, however, privately-financed infrastructure projects do not fall under a separate body of law and are dealt with by rules governing the activity to which the project pertains.

16. The *Guide* uses the word "concession" to refer generally to the right given to the project company or consortium to construct and operate the public infrastructure facility and to charge for its use or for the services or goods it generates. As used in the *Guide*, the word "concession" is not to be understood in a technical meaning that may be attached to it under any particular legal system or national laws.

17. The expressions "concession agreement" and "concession contract" are used in some legal systems to refer to the agreement between the host Government and the project company or consortium setting forth the conditions for the implementation of the project. In the *Guide* the words "project agreement" are used in that meaning.

18. Another related term is the word "concessionaire", which often is used to refer to the private entity which is awarded the concession by the host Government. When used in the *Guide*, such word is a synonym of "project company" or "project consortium".

4. Host Government and related expressions

19. The expression "host Government" is generally used in the *Guide* to refer to the national, provincial or local authority which has the overall responsibility for the project and on behalf of which the project is awarded.

20. The term "procuring entity" is used in the *Guide* to refer to the organ, agency or official within the host Government which is responsible for selecting the project sponsors and awarding the project. Depending on the system of the host country, more than one organ, agency or official may be involved in the selection process and related procedures leading to the award of the project.

21. The expression "regulatory body" is used in the *Guide* to refer to the governmental organ or entity, or a body created by statute, that is entrusted with the authority to issue rules and regulations governing the operation of the infrastructure facility. In some countries, that authority is vested in the procuring entity itself.

5. Lenders and international financial institutions

22. The word "lenders", as used in the *Guide*, refers to public or private financial entities which extend loans for the implementation of the project.

23. The *Guide* uses the words "international financial institutions" to refer to intergovernmental organizations that may provide funds or financial guarantees to the implementation of development projects, such as the World Bank, the International Finance Corporation, the Multilateral Investment Guaranty Agency, as well as regional development banks, such as the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, or the Inter-American Development Bank. When no distinction is made in the *Guide*, the word "lenders" includes international financial institutions providing loans to the project.

6. Turnkey contract

24. The *Guide* uses the term "turnkey contract" to refer to a construction contract whereby a single contractor is engaged to perform all obligations needed for the completion of the entire works, i.e. the transfer of the technology, the supply of the design, the supply of equipment and materials, the installation of the equipment and the performance of the other construction obligations (such as civil engineering and building).2/ In a turnkey contract, the contractor is

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2/ The notion of turnkey is discussed in the *UNCITRAL Legal Guide on Drawing Up International Contracts for the Construction of Industrial Works*, New York, 1988, United

normally obliged to undertake all necessary works so that the purchaser receives a facility which is ready for being put to operation.

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Nations Publication, Sales No. E.87.V.10 (hereafter referred to as the "*UNCITRAL Construction Legal Guide*"), p. 16.

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PRIVATELY-FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately-financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter II. PARTIES AND PHASES OF PRIVATELY-FINANCED INFRASTRUCTURE PROJECTS

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A. General remarks

1. The following sections discuss basic issues such as private-sector participation in public infrastructure projects and the concept of project finance, identify the main parties to those projects and their respective interests, and briefly describe the evolution of a privately-financed infrastructure project. These sections are conceived as general background information on matters that are examined from a legislative perspective in the subsequent chapters of the *Guide*.

B. Private sector and public infrastructure

2. The construction and operation of infrastructure facilities that are used by the general public or that deliver certain commodities to the general public has traditionally been undertaken by the State or by entities with a special status under national law. Entities operating public infrastructure facilities are often regarded as providers of "public utilities" or "public services", although the notions of "public utilities" or "public services" have evolved over time and vary widely among States. In some countries most types of infrastructure have remained primarily the public sector's responsibility, while in a number of countries private entities have been allowed to invest in infrastructure connected to some form of "public service" or "public utility". Where private sector investment in infrastructure is allowed, it may require a governmental authorization sometimes called "licence", "franchise" or "concession".

3. During the nineteenth century, large investments were made by the private sector in the infrastructure and public utilities of many countries under various types of concessions. Significant portions of the world's railways, electricity and telecommunications networks were originally developed by the private sector. In some countries, concessionaires were given an exclusive right to develop and operate infrastructure facilities and to establish rules for their use by the public, while elsewhere the State retained some form of regulatory control in that respect.

4. Private investment in infrastructure declined significantly in the course of the twentieth century, when the execution of large-scale projects was largely undertaken by governmental entities and financed with public funds or debt in the form of loans obtained from national or foreign banks or international financial institutions. In some countries, this trend was accompanied by an expansion of the notions of "public services" or "public utilities" so as to cover a number of activities thus far carried out by the private sector. Special public entities were often established by national Governments and were given exclusive concessions within given territories.

5. A different development has taken place in recent years, as budgetary and financial constraints faced by the public sector in both developing and developed countries have led a number of States to devise alternatives to public funding for meeting expanding demands for infrastructure projects. Private sector financing is being increasingly called upon for the development of public infrastructure, and in some countries it has become an integral part of governmental programmes for the modernization or expansion of infrastructure. A variety of

alternative arrangements for infrastructure development has evolved, ranging from transactions where the infrastructure is built and operated by private entities for an agreed period, but is eventually transferred to the Government, to situations where the infrastructure is privately owned and operated.

6. The large scale of modern infrastructure projects, complex financing techniques and the multiplicity of parties involved make infrastructure projects considerably more elaborate than traditional privately-financed infrastructure projects. Modern privately-financed infrastructure projects are usually developed under the "project finance" modality, which is briefly examined below.

C. The concept of project finance

7. "Project finance" is a financing modality in which the repayment of loans taken by the borrower is primarily assured by the revenue generated by the project, rather than by other guarantees given or obtained by its sponsors. To that end, the project's assets and revenue, and the rights and obligations relating to the project, are independently estimated and are strictly separated from the assets of the project sponsors. Due to the absence or limited role of personal guarantees or securities provided by the project sponsors, project finance is said to be "non-recourse" or "limited recourse" financing.

8. Debt capital usually represents the main source of funding for infrastructure projects implemented under the project finance modality. It is obtained in the financial market primarily by means of loans extended to the project sponsors or the project company by commercial banks, typically using funds which originate from short to medium-term deposits remunerated by those banks at floating interest rates. Consequently, loans extended by commercial banks are also subject to floating interest rates and have normally a maturity term shorter than the project period. The risks to which the lenders are exposed in project finance are considerably higher than in traditionally secured transactions, even more so in the case of infrastructure projects where the security value of the physical assets involved (e.g. a road, bridge or tunnel) would rarely cover the total financial cost of the project, given the lack of a "market" where such assets could be easily realized. Therefore, lenders are seldom ready to commit the large amounts needed for infrastructure projects solely on the basis of a project's expected cash flow or assets. Indeed, infrastructure projects are often financed on a basis which, while primarily relying on the project's cash flow and assets, with recourse to the project company, reduces the lenders' exposure by incorporating a number of back-up or secondary security arrangements and other means of credit support provided by the host Government, project sponsors, purchasers or other interested third parties.

9. In addition to debt, capital is also provided to infrastructure projects in the form of equity. Equity capital is obtained in the first place from the project sponsors or other individual investors interested in taking stock in the project company. However, such equity capital normally represents only a portion of the total cost of an infrastructure project. In order to obtain commercial loans or to have access to other sources of funds to meet the capital

requirements of the project, project sponsors and individual investors have to offer priority payment to the lenders and other capital providers, thus accepting that their own investment will only be paid after payment of those other capital providers. Therefore, project sponsors, as the main promoters of the project, assume the highest financial risk. At the same time, projects sponsors will hold the largest share in the project's profit, once the initial investment is paid.

10. Other complementary sources of equity capital may include investment funds and other so-called "institutional investors" such as insurance companies, mutual funds or pension funds. These institutions normally have large sums available for long-term investment and may represent an important source of additional capital for infrastructure projects. They may provide capital in the form of debt or equity participation via investment funds. Normally, institutional investors do not participate otherwise in the development of the project or the operation of the facility. Their main reasons for accepting the risk of providing capital to infrastructure projects are the prospect of remuneration and the interest in diversifying investment.

D. Parties to the project

1. The host Government

11. For a number of reasons, the host Government plays a crucial role in the execution of privately-financed infrastructure projects. The host Government normally identifies the project pursuant to its own policies for infrastructure development, establishes its specifications and conducts the process that leads to the selection of the project sponsors. Furthermore, throughout the life of the project, the host Government may need to provide various forms of support - legislative, administrative, regulatory and sometimes financial - so as to ensure that the infrastructure is successfully built and adequately operated. Finally, in a typical "build-operate-transfer" project, the host Government becomes the ultimate owner of the facility.

12. The host Government has a legitimate interest in ensuring that the project is properly executed and that the construction works meet the specifications. Thus, national laws often spell out in some detail the right of the Government to monitor the execution and operation of the project, a task that might involve governmental officials at different offices and ministries, and which requires an adequate level of coordination among them. For that purpose, some countries have found it helpful to appoint a specific agency, committee or officer invested with the authority to coordinate all monitoring procedures in connection with the project.

13. The host Government also has an interest in receiving high quality infrastructure that will benefit the national economy by the provision of needed goods (e.g. electricity, gas), services (e.g. water treatment, waste removal) or the facilitation of transport and trade (e.g. harbours, roads, tunnels). Additionally, the host Government might be interested in creating employment opportunities for local workers, or gaining advanced technology related to the project. Those objectives are often reflected in the pertinent legislation in provisions concerning technology transfer or preferences for companies that undertake to hire local personnel.

14. Another objective pursued by the host Government may be to achieve a more efficient management of public infrastructure, since private companies are believed to operate more cost-effectively than public entities. However, the host Government remains ultimately accountable for the project and will therefore be interested in ensuring that the infrastructure is operated in a manner consistent with the overall policy of the country for the sector concerned. Issues affecting the general public, such as quality of services and level of tariffs, are of particular concern for the host Government. Thus, the host Government may wish to retain the right to exercise some form of control over the operation of the project, sometimes through a special regulatory body.

2. Project sponsors and project company

15. The bulk of the investment in the project, in terms of money, supplies and labour, is made in the construction, expansion or renovation of the infrastructure. Thus, the group of project sponsors usually includes construction and engineering companies and suppliers of heavy equipment interested in becoming the main contractors or suppliers of the project. Those companies will be intensively involved in the development of the project during its initial phase, and their ability to cooperate with each other and to engage other reliable partners will be essential for a timely and successful completion of the works. However, by the very nature of their business, construction companies and equipment suppliers may not be at ease with a long-term equity participation in a project. Therefore, they will often seek to involve a company with experience in the operation and maintenance of the type of infrastructure being built. The presence of such a company may be encouraged by the host Government as an assurance that the technical feasibility and the financial viability of the project in all its phases, and not only during the construction period, have been adequately considered.

16. For the project sponsors it is important to have a return on their investment commensurate with the amount of risk they assume. Besides commercial aspects, such as the level of revenue that the project is expected to generate, the legal security afforded to investments in the host country will play an important role in the decisions of prospective project sponsors to invest in a given project. In particular, the sponsors will seek to obtain assurances that their investment will be protected from confiscation or dispossession; that they will be able to convert into foreign currency the revenue earned in local currency; and that they will be able to repatriate or take abroad their profits and residual investment after the expiry of the project term. They may, therefore, look for corresponding assurances from the host Government.

17. The desire to limit their liabilities to the amount of their equity investment normally leads the project sponsors to establish a limited liability company (such as a stock company) with juridical personality, assets and management of its own for the specific purpose of carrying out the project. Sometimes, the shareholders of the project company may also include "independent" equity investors not otherwise engaged in the project (usually institutional investors, investment banks, bilateral or multilateral lending institutions, sometimes also the

host Government or a State-owned corporation). The participation of private sector investors from the host country is sometimes required by the national law.

18. The project company will have the overall responsibility for the project and will establish a number of contractual arrangements with construction contractors, equipment suppliers, the operation and maintenance company and other contractors, as required for the implementation of the project. The project company normally becomes the vehicle for raising the financial means required in addition to the equity contributed by the sponsors.

3. Lenders and international financial institutions

19. Due to the magnitude of the investment required for a privately-financed infrastructure project, loans are often organized in the form of "syndicated" loans with one or more banks taking the lead role in negotiating the finance documents on behalf of the other participating financial institutions, mainly commercial banks. Commercial banks have considerable experience in project finance and, together with the project sponsors, they normally devise instruments that suit the needs of a particular project. Commercial banks are sensitive to the need for preserving the project company's payment capacity, and often show flexibility in respect of extensions of loans or renegotiation of their terms. At the same time, however, commercial banks insist on minimizing their exposure to completion, commercial, political or other project risks.

20. Before agreeing to finance the project, the lenders usually review carefully the economic and financial assumptions of the project so as to assure themselves of its feasibility and commercial viability. Subsequently, arrangements will be made to limit as much as possible the risk of default. One is the priority payment of commercial debts before any other sources of capital are paid, i. e. before payments are made to other creditors or dividends are distributed to equity investors or project sponsors. Also, the lenders usually demand security in the form of mortgages, fixed or floating charges over all the assets of the project, assignments of future receivables arising from the operation of the project, automatic deposit of an agreed part of those proceeds into a blocked account (often outside the State where the project is located), governmental guarantees, or the ability to appoint a substitute in the event of default or inability of the project company to perform its obligations. The greater the amount of security the laws of the host country allow, the greater is the likelihood that financing will be available for the project at a more favourable rate. The possible role of national legislation in this respect is discussed in chapter VI, "The project agreement" [yet to be drafted].

21. International financial institutions and export credit agencies may also play a significant role in privately-financed infrastructure projects. A number of projects have been co-financed by the World Bank, the International Finance Corporation, or by regional development banks. The participation of international financial institutions or export credit agencies may facilitate the project sponsors' task of raising funds in the international financial market by providing commercial banks with protection against a variety of political risks, including, *inter alia*, the failure of the host Government to make agreed payments, to make available sufficient foreign

exchange or to grant necessary regulatory approvals. International financial institutions may also play an instrumental role in the formation of "syndications" for the provision of loans to the project. Some of those institutions have special loan programmes under which they become the sole lender of record to a project, acting on its own behalf and on behalf of participating banks and assuming the responsibility for processing disbursements by participants and for subsequent collection and distribution of loan payments received from the borrower.

4. Other capital providers

22. Capital providers other than commercial banks and international financial institutions may include "institutional investors" such as insurance companies, mutual funds, pension funds or investment funds. Under the terms of their investment, those other capital providers are usually entitled to priority payment of principal and interest, or priority dividend payment, before dividends are distributed to the project sponsors and other shareholders of the project company. They will often have the right to receive periodic reports and financial statements. In the case of institutional investors holding preferential shares or debentures, they will enjoy other rights available to them under the laws of the country where the project company is established or where the shares or debentures were issued, which may include any of the following: the right to be collectively represented by an agent; the right to be consulted on and to approve certain changes in the statutes of the project company; a preferential right to amounts distributable on liquidation.

23. One additional group of potential capital providers may be Islamic financial institutions. Those institutions operate under rules and practices derived from the Islamic legal tradition. One of the most prominent features of banking activities under Islamic rules is the absence of interest payments, and consequently the establishment of other forms of consideration for the borrowed money, such as profit sharing or direct participation of the financial institutions in the results of the transactions of their clients. As a consequence of their operating methods, Islamic financial institutions may be more inclined to considering direct or indirect equity participation in a project than other commercial banks. At the same time, Islamic financial institutions would give emphasis to reviewing economic and financial assumptions of projects for which financing is sought and would follow closely all phases of its implementation.

5. Construction contractors and suppliers

24. Often one or more of the companies that conclude contracts with the project company for the construction of the infrastructure facility or the supply of equipment are also sponsors of the project.

25. The construction contractor or contractors will usually assume responsibility for the design of the facility and caretaking of it through all stages of construction until its physical completion. Their main interest will be to be able to complete the works within the agreed schedule and within the original cost estimate. So as not to incur delay in the construction works, the contractors will desire access to necessary supplies (e.g. cement, fuel, steel,

electricity, water) and will seek assurances that they will be allowed to import into the country all equipment and materials they might require. They will also be concerned with their ability to hire local and international personnel of their choice. Like the project company, the foreign construction contractors and suppliers will expect to be able to convert into foreign currency and transfer abroad any revenue earned in local currency.

6. Operation and maintenance company

26. Among all contractors retained by the project company, the contractor or contractors responsible for the operation and maintenance of the infrastructure facility are the ones with the longest lasting involvement in the project. The operating company in particular will be in a singular position, as the task of operating the facility will place it in direct relation with its customers and will expose the operating company to public scrutiny. For those reasons, the operating company's viewpoint as regards the assessment of the economic and financial viability and profitability of the project may differ from the viewpoint of the other project sponsors and, therefore, it may be valuable to obtain the input of the prospective operating company at the early stages of the project.

27. Possible methods of paying for the operation and maintenance of the infrastructure may vary from lump-sum payments to cost-plus methods, in which the variable portion above and beyond the recovery of costs may be either a fixed sum, a percentage of the cost or a share in the revenue of the project. Combinations of any of those methods are also common. The project company will normally establish some form of control mechanism over the operation of the facility (e.g. audit rights and cost review) so as to ensure that the operating costs are kept as much as possible within original estimates. Where the reimbursement of costs is subject to a maximum ceiling, the interest to reduce cost will be shared with the operating company.

28. The performance by the operation and maintenance company is normally subject to standards of quality that may derive from many different sources, including the law, the project agreement, the operation and maintenance contract or the instructions or guidelines issued by the competent regulatory body. In addition to that, a number of other requirements may be contained in legislation such as labour or environmental law. The operation and maintenance company is thus usually required to provide performance or surety bonds, and to purchase and maintain adequate insurance, including casualty insurance, workmen's compensation insurance, environmental damage and third party liability insurance.

29. The operation and maintenance company will need clear operating requirements and regulations and will seek to obtain assurances from the project company or the host Government that it will be able to operate and maintain the facility without undue interference. Potential conflicts with the host Government may arise as a result of changes in national laws or regulations that impose higher standards for the operation of the facility, or in the course of the exercise by the Government of its monitoring rights.

7. Insurers

30. Privately-financed infrastructure projects involve a variety of risks pertaining to the construction and operational phases of the project and which may well exceed the capacity of the project company, the host Government, the lenders or the contractors, to absorb. Thus, obtaining adequate insurance against such risks is essential for the viability for a privately-financed infrastructure project. Typically, an infrastructure project will involve casualty insurance covering its plant and equipment, third party liability insurance, and workmen's compensation insurance. Other possible types of insurance include insurance for business interruption, interruption in cash flows, and cost overrun insurance. Those types of insurances are usually available at the commercial insurance markets, although the availability of commercial insurance may be limited for certain *force majeure* risks (e.g. war, riots, vandalism, earthquakes, hurricanes) which one or more of the parties will need to absorb. For some categories of risks, such as political risks, the project may require guarantees provided by international financial institutions, such as the World Bank or the International Financial Corporation, or by export credit agencies.

E. Phases of execution

31. Privately-financed infrastructure projects evolve through a number of phases from the initial identification of the project and the selection of the project sponsors, the conclusion of the project agreement and related instruments, the execution of the construction or modernization works to the operation of the infrastructure facility and possibly the transfer of the project to the host Government.1/

1. Identification of the project

32. With the possible exception of projects that result from unsolicited proposals by the private sector, it is normally the host Government that identifies projects to be carried out in order to meet the national needs for infrastructure development. From a legislative perspective, two important questions for the development of the project will normally have to be considered at this early stage, namely, what type of private sector involvement is sought for the project and who is authorized to act on behalf of the host Government.

33. One of the initial steps taken by the host Government in respect of a proposed infrastructure project is to conduct a preliminary assessment of its feasibility, including economic and financial aspects such as expected economic advantages of the project, estimated cost and potential revenue anticipated from the operation of the infrastructure facility. It is also important

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1/ This section discusses selected issues that arise in connection with different phases of a privately-financed infrastructure project. For more information, including an analysis of economic, financial and management issues, the reader is advised to consult general literature on the subject, such as the *UNIDO BOT Guidelines*.

at this stage to assess the technical feasibility of the project as well as its environmental impact. The preliminary conclusions reached by the host Government at this stage will play a crucial role in conceiving the type of private sector involvement that is sought for the implementation of the project, for instance, whether the infrastructure facility will be owned by the host Government and temporarily operated by the private entity, or whether the facility will be owned and operated by the private entity. The choice of the modality of private sector participation will be significant for a series of legal issues commonly dealt with in the legislation, such as the procurement of land (see chapter V, "Preparatory measures", paras. 1-15) and ownership of the infrastructure facility and related assets (see chapter VI, "The project agreement" [yet to be drafted]).

34. Following the identification of the future project, it is for the host Government to establish its relative priority and to assign human and other resources for its implementation. At that point, it is desirable that the host Government review existing statutory or regulatory requirements relating to the operation of infrastructure facilities of the type proposed with a view to identifying the main governmental bodies that have to give approvals, licences or authorizations or which have to be otherwise involved in the project. Depending on the importance and level of authority assigned to the project, the host Government, at that stage, may wish to designate an office or agency for the purpose of coordinating the input of other offices and agencies concerned and monitoring the issuance of licences and approvals (for further consideration of this issue, see chapter V, "Preparatory measures", paras. 38-44).

2. Selection of project sponsors

35. Once a project has been identified, its viability and feasibility have been assessed, and the need or interest for private financing have been confirmed, the host Government will turn to the selection of the project sponsors by using methods prescribed in the relevant legislation. Often, the selection method involves competitive tenders or proposals submitted by a selected number of candidates which have met the relevant prequalification requirements (for a discussion of legislative issues relating to the choice of a selection method and process, see chapter IV, "Selection of the project sponsors" [yet to be drafted]).

36. The confidence of prospective project sponsors in the viability of the project and their readiness to invest the time and funds required for preparing tenders or proposals is often influenced by their assessment of the rules governing the selection process. Prospective project sponsors might be discouraged to participate in a selection process that they perceive as unclear or cumbersome. Therefore, for Governments wishing to attract private sector investment in infrastructure it might be advisable to have procedures in place that maximize economy and efficiency in procurement, provide a fair and equitable treatment of all prospective project sponsors and ensure transparency in the selection process.2/

2/ Those are some of the objectives of public procurement set forth in the preamble to the UNCITRAL Model Law on the Procurement of Goods, Construction and Services, adopted by the United Nations Commission on International Trade Law (UNCITRAL) at

37. Whatever method is chosen by the host Government, the selection process for infrastructure projects is often complex and might require considerable time and entail significant cost for prospective project sponsors, thus adding to the overall cost of the project. Ensuring that documents distributed to prospective sponsors are sufficiently clear and contain all elements necessary for the preparation of their tenders or proposals is important to reduce the need for clarifications, as well as minimize the potential for complaints or disputes. Furthermore, many Governments have found it useful to provide the prospective project sponsors with a sample of the project agreement to be entered into with the selected sponsors, so that they may familiarize themselves with the obligations normally assumed by a concessionaire under the laws of the host country. The legislation plays a significant role by providing guidance to the procuring entities in the host country as to essential elements to be taken into account in all selection processes concerning privately-financed infrastructure projects.

3. Preparations for the implementation of the project

38. Following the selection of the project sponsors, a number of measures will have to be taken with a view to beginning the implementation of the project. Often, the project sponsors will establish an independent legal entity to carry out the project, and with which the host Government will conclude a project agreement. The project agreement will set forth the obligations of the parties concerning the implementation of the project. For projects as complex as infrastructure projects, it is not unusual that several months elapse in negotiations before the parties are ready to sign the project agreement. A number of factors have been reported to cause delay in the negotiations, such as inexperience of the parties, poor coordination between different governmental agencies, uncertainty as to the extent of governmental support, or difficulties in establishing security arrangements acceptable to the lenders.3/ A significant contribution may be made by the host Government by ensuring appropriate coordination between all offices and agencies involved, or by identifying in advance the types of guarantees and facilities it may provide to the implementation of the project (see chapter VII, "Government support" [yet to be drafted]). The clearer the understanding of the parties as to the matters to be provided in the project agreement, the greater the chances that the negotiation of the project agreement will be conducted successfully. Conversely, where important issues remain open after the selection process and little guidance is provided to the negotiators as to the substance of the project agreement, there might be considerable risk of costly and protracted negotiations. The legislation may help the parties to achieve a timely conclusion of the project agreement by

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its twenty-seventh session, in 1994 (printed in UNCITRAL Model Law on Procurement of Goods, Constructions and Services, with Guide to Enactment. United Nations, New York, 1995).

3/ For a discussion of issues having an impact on achieving financial closure, see International Finance Corporation, Financing Private Infrastructure, Washington, D.C., 1996, p. 37.

identifying essential issues that need to be dealt with therein (for further discussion of this topic, see chapter VI, "The project agreement").

39. In addition to the conclusion of the project agreement and related instruments, the project company will also enter into agreements with the lenders for the provision of loans for the implementation of the project and will establish contractual arrangements with contractors and suppliers. Moreover, a number of other arrangements are usually made in the period immediately following the award of the project in preparation for the commencement of the construction. Preliminary inspections of the site of the project will take place prior to the construction. The project company may also have at this stage to bring in the country the equipment and other material, as well as the personnel required for the execution of the project. Where licences are required, the host Government will be instrumental in avoiding unnecessary delays (see chapter V, "Preparatory measures").

4. Construction phase

40. Following the satisfactory completion of the preliminary arrangements referred to above, funds may be disbursed for the implementation of the project and the construction or modernization works may begin. It is during the construction phase that most of the investment is made in the project, at a time when no revenue is yet generated by the infrastructure facility. Thus, the overall financial viability of the project is largely predicated upon a successful construction phase. Delays in the construction and cost overruns are the two main reasons of concern for all the parties involved. The lenders will insist that those risks be assumed by the project company and its contractors, of whose competence and reliability they will wish to be assured.

41. From the perspective of the host Government, delay and cost overruns also carry negative political implications and may undermine the credibility of the host Government's policy on privately-financed infrastructure projects. The host Government usually requires the project company to assume full responsibility for the timely completion of the construction. Therefore, a number of provisions will be made in the project agreement, sometimes pursuant to a statutory requirement, so as to deal with the possible consequences of those situations, such as provisions on performance bonds or sureties, insurance requirements, or penalties and liquidated damages. Possible legislative approaches to dealing with these issues are considered in chapter X, "Performance issues". Furthermore, the host Government, as well as the lenders, will want to be assured that the technology proposed for the implementation of the project has been sufficiently used and is of proven safety and reliability. They will consider with great caution any suggestion to use new or untested technologies. In any event, a number of tests may be required to be performed prior to final acceptance of the infrastructure facility.

42. Completion and cost-overrun risks will normally be allocated by the project company to the construction contractors and, for that purpose, the construction contract will normally be a fixed-price, fixed-time turnkey contract with guarantees of performance by the contractors. The contract may require the construction contractor to provide warranties that the infrastructure

facility will operate to predetermined performance standards. Also, the equipment suppliers may be asked to provide extensive warranties at to the fitness of the technology provided.

5. Operational phase

43. After completion of the construction works, and upon authorization by the host Government for the operation of the facility, begins the longest phase of the project. During that phase the project company undertakes to operate and maintain the infrastructure facility and to collect revenue from the users. Conditions for the operation and maintenance of the facility, as well as quality and safety standards, are often provided in the law and spelled out in detail in the project agreement. In addition to that, a regulatory body may exercise an oversight function over the operation of the facility, as further discussed in chapter IX, "Operational phase".

44. For the project company, the revenue generated by the infrastructure facility is the sole source of funds for repaying its debts, recouping its investment and making profit. Therefore, one of the main concerns of the project company during the operational phase is to avoid as much as possible any interruption in the operation of the facility and to protect itself against the consequences of any such interruption. In this respect, the interests of the lenders will normally be convergent with those of the project company. Therefore, it will be important for the project company to ensure that supplies and power needed for the operation of the facility will be constantly available. Also, the project company will be concerned that the exercise by the host Government of its monitoring or regulatory powers does not cause disturbance or interruption in the operation of the facility, nor that it results in additional costs to the project company.

45. In general, the host Government, too, will be interested in ensuring the continuous provision of services or goods to the users and customers of the infrastructure facility. At the same time, however, the host Government will also have a legitimate interest in ensuring that the operation and maintenance of the facility are performed in accordance with the applicable quality and safety standards or operating rules and conditions. These aspects will be of particular concern for the host Government in respect of infrastructure facilities open to use by the general public (such as a bridge or tunnel) or of a hazardous nature (such as power plants or gas distribution facilities). The particular perspective of the host Government, which results from its being accountable to the public for the infrastructure facility, may lead to conflicts or disagreements with the project company. Thus, the importance of having in place clear rules concerning the operation of the infrastructure facility and of establishing adequate methods for settling disputes between the host Government and the project company that might arise at that phase of the project.

6. Termination of the project

46. With the possible exception of those cases where the infrastructure facility is to be permanently owned by the project company, most privately-financed infrastructure projects are undertaken for a certain period. In some projects, extensions of the project period in favour of the same project company may be possible; in other cases, the law requires instead the selection

of a new concessionaire through a competitive method (a more detailed discussion of these issues is contained in chapter XI, "Expiry, extension and early termination of the project agreement").

47. In yet other projects, such as "build-own-operate" projects, the infrastructure facility and all related assets and equipment is transferred to the host Government at the end of the project term. In those cases, the host Government will be interested in ensuring that modern technology has been transferred, that the infrastructure facility has been properly maintained, and that national personnel has been adequately trained for the operation of the facility.

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PRIVATELY- FINANCED INFRASTRUCTURE PROJECTS

Draft chapters of a legislative guide on privately-financed infrastructure projects

Report of the Secretary-General

Addendum

Chapter V. PREPARATORY MEASURES

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A. The project site

1. Acquisition of land for the construction of the facility

1. One of the essential preparatory measures for the execution of an infrastructure project is the acquisition of the land and other property necessary for the construction of the infrastructure facility. Often such land is provided by the host Government, but sometimes it is purchased by the project sponsors. In either case, the legislation of the host country may play an important role in facilitating the acquisition of the required land, thus helping to expedite the implementation of the project.

2. Where a new infrastructure facility is to be built on land owned by the host Government, or an existing infrastructure facility is to be modernized or rehabilitated (such as in "modernize-operate-transfer" or "rehabilitate-operate-transfer" projects), it will normally be for the host Government, as the owner of such land or facility, to make it available to the project company. The host Government may either transfer to the project company title to the land or facilities, or retain title thereto, while granting the project company a right to use the land or facilities and built upon it, a question which is considered below in chapter VI, "The project agreement" [yet to be drafted].

3. A number of countries have extensive provisions on the preservation and protection of State property, including special procedures and authorizations required for transferring the title to such property to private entities or granting to private entities the right to use governmental property. Whatever choice is made by the host Government regarding the ownership of the infrastructure facility to be built, modernized or rehabilitated, it might be desirable for the law to include an authorization to the host Government to transfer or make available to the project company any land or existing infrastructure required for the execution of the project.

4. Both in cases where the infrastructure facility is to be transferred back to the host Government or is permanently owned by the project company, the parties might be interested in establishing the value and the condition of such land and facility at the time it is handed over to the project company. Therefore, in addition to matters which would be typically dealt with in the project agreement (e.g. procedures for handing over the land or facilities, documentation required, stamp duties), it might be useful for the law to require that such land and existing facility be inspected, measured and demarcated prior to being transferred or made available to the project company. An example of a possible provision to that effect, combined with an authorization for the host Government to transfer land to the project company, might be drafted along the following lines:

> 1. The Government is authorized to make available to the concessionaire the land, buildings or other property required for the execution of the project for the duration of the concession period.

2. The project agreement shall provide the procedures for the inspection, demarcation and valuation of such land, buildings or other property and for recording the condition in which they are found prior to being made available to the concessionaire.

5. The situation may become more complex in the case of new infrastructure facilities to be constructed on land that is not already owned by the host Government and that needs to be purchased from its owners. National legislation often provides that the host Government is to acquire the land and make it available for the purposes of the project, although in some cases the necessary land may be purchased by the project sponsors.

6. Acquisition of land by the project company might be used for the development of projects that originate from an unsolicited proposal from the private sector. Particularly in the case of infrastructure facilities of relatively high commercial potential that are not deemed to be a national priority, the host Government might not see a compelling reason for undertaking to acquire the land and make it available to the project company. However, the host Government may still play an important role by assisting the project company to obtain approvals and licences for owning such land, or waiving restrictions or prohibitions, possibly of a legislative nature, that might exist to its ownership by the project company.

7. In most cases, however, the project company will be reluctant to assume the responsibility for purchasing the land needed for the project. The project company may fear the potential delay and expense entailed by having to negotiate with possibly a large number of individual owners and, as necessary in some parts of the world, to undertake complex searches of title deeds and review of chains of previous property transfers so as to establish the regularity of the title of individual owners. Furthermore, publicity concerning the planned infrastructure may raise the price of the land, so that the final sum paid by the project company may exceed its original cost estimate. In the case of projects identified by the host Government, there may also be a national interest in avoiding unnecessary delay or increase in the project cost as a result from the acquisition of land for the construction of the facility.

8. With a view to eliminating the above-mentioned difficulties, the host Government may be willing to assume the responsibility for providing the land required for the implementation of the project, either by purchasing it from its owners, or by acquiring it through expropriation. A number of countries have specific legislation governing expropriation procedures, which might be applicable to expropriation required for privately-financed infrastructure projects. In some countries there may be different types of expropriation procedures depending on their purpose. Although the conditions and procedures for expropriating private property vary greatly in legal systems, the procedure often entails at least two distinct phases.

9. The need for expropriating the property may be established at an initial phase, when the intention of the Government to expropriate the property in question is also made known to the owners or purported owners. In some countries, the host Government may be required to attempt to purchase the property from its owners, prior to resorting to compulsory measures. In other

countries such limitations may not exist. In a number of countries, the Government is required to give notice of its intention to expropriate the property to the owner or to the general public by a special act of the Government, as a necessary condition for proceeding with the expropriation. The act that gives such notice is known under different expressions in different legal systems, such as "condemnation decree", or "declaration of public utility". For convenience purposes, such an act is referred to hereafter as "expropriation decree".

10. The issuance of such an act is often followed by a second phase, during which the compensation due to the owner is estimated and paid. In some countries, the entire expropriation procedures are carried out by the administration, while in other countries the second phase of the expropriation procedures takes the form of a court action. Often the Government will not own the property and will not be authorized to take possession of it unless and until appropriate compensation has been paid to the owners of the property. However, under certain circumstances, such as emergency situations or compelling public need, some laws authorize the court or other authority presiding over the expropriation to authorize the Government to take possession of the property immediately after the opening of the proceedings, often subject to the deposit of a sum commensurate with the value of the property.

11. The right to expropriate private property is usually vested in the Government, but the laws in a number of countries also extend that right to other entities, in addition to the Government. The laws in a number of countries authorize non-governmental entities carrying out certain activities, such as public utility undertakings or concessionaires of public services (e.g. railway companies, electricity authorities, telephone companies), to perform certain actions for the expropriation of private property required for providing or expanding their services to the public. However, some involvement of the Government is still required. For example, the law may provide that the Government has to issue the expropriation decree, while the concessionaire remains responsible for all subsequent steps of the expropriation procedures, including the payment of compensation to the owners.

12. Expropriation procedures are ordinarily lengthy and complex. They may also involve a number of officials at different ministries or levels of Government. Particular delay may be encountered in some countries where the expropriation takes the form of court proceedings. The host Government might thus wish to review existing provisions on expropriation for reasons of public interest with a view to assessing their adequacy to the needs of large infrastructure projects and to determining whether such provisions allow quick and cost-effective procedures, with due consideration to the rights of the owners.

13. In countries where the law contemplates more than one type of expropriation proceedings, it was found desirable to provide that all expropriations required for privately-financed infrastructure projects are to be carried out pursuant to the more expeditious of those proceedings, such as the special proceedings that in some countries apply in emergency situations or for reasons of compelling public need. In some countries it was also found useful to make use of the possibility given by their laws to delegate to the concessionaire the authority to carry the expropriation, while the host Government remained responsible for accomplishing those acts that,

under the relevant legislation, are legal requirements for initiating expropriation proceedings (see above, para. 9). Making use of that possibility might be advantageous for both the host Government and the project company, particularly in those countries where the award of compensation to the owners of the property expropriated is adjudicated in court proceedings, when the parties expect that the concessionaire might be able to handle those proceedings more expeditiously than the host Government. The parties may agree that the entire cost of the expropriation be borne by the project company, or that the host Government will bear some of that cost.

14. Measures such as those mentioned in the preceding paragraph might enable the execution of the project to begin soon after the project award, instead of having to await a final settlement of the question of compensation payable to the owners. For that purpose, in countries where those measures are possible under the relevant legislation, specific laws on privately-financed infrastructure projects might contain only essential provisions and refer to other legislation, as exemplified in the following set of provisions:

> 1. Except as otherwise provided herein, the expropriation of private property required for the construction of an infrastructure facility pursuant to this law shall follow the procedures provided in the [*identify the laws governing expropriation procedures*].
>
> 2. The Government shall be responsible for issuing the [expropriation decree] [and performing other acts that are required under the law for the expropriation of the property].
>
> 3. The Government may authorize the concessionaire to carry out the expropriation, in which case [*option 1*: the concessionaire shall bear all the costs associated with the expropriation procedure] [*option 2*: the project agreement shall establish the respective obligations of the Government and the concessionaire in respect of the costs associated with the expropriation procedure] including the payment of compensation arising out of such expropriation, attorney's fees and judicial costs.
>
> 4. The court or other competent authority may authorize the concessionaire to take possession of the property upon opening of the expropriation proceedings [and deposit of the value of the property].

15. Upon expropriation, title to the land is often vested in the host Government, although in some cases the law may authorize the host Government and the project company to agree on a different arrangement, taking into account their respective shares in the cost of expropriating the property (see chapter VI, "The project agreement" [yet to be drafted]).

2. Right of way and other easements

16. Besides the acquisition of property for the construction of the facility, there might be a need for ensuring the project company's access to such property, in cases where the location of the site of the project is such that access to it requires transit on or through the property of third parties. Such a right of transit is in national laws referred to by expressions such as "right of way". The nature of the project may also be such that it requires the project company to enter property belonging to third parties (e.g. to place fixed installations or cables or to provide services directly to its customers such as in distribution of gas, water, or electricity). Such rights to use another person's property or to do work on it are referred to by expressions such as "easements" or expressions of similar meaning. Hereafter, rights of way, easements and similar rights are generally referred to by the word "easement".

17. Easements usually require the consent of the owner of the property to which they pertain, unless such rights are provided by the law. Generally, there might be three possible ways for the project company to acquire easements: the project company might acquire them directly from the owners of the properties concerned; the host Government might acquire and transfer them to the project company; or the law may grant such rights directly to the project company.

18. The host Government in some cases may prefer to leave it for the project company to negotiate easements with the owners of property. In that case there might be no need for a legislative provision dealing with the matter, and the parties may provide in the project agreement that the project company alone would be responsible for acquiring such rights. The parties might find such a procedure to be feasible for projects where the scope of the easements would be limited to a certain number of previously identified properties adjacent to the project site. However, in other cases such a procedure might not represent an expeditious or cost-effective alternative, particularly where the company would need to acquire easements from multiple owners. Thus, the host Government might prefer to acquire and grant to the project company the necessary easements.

19. In cases where the project site is acquired by the host Government or the project company through expropriation, the question of easements might be dealt with in conjunction with the expropriation of the project site. The scope of the expropriation may thus be defined as covering, in addition to the project site, easements in other lands to the extent necessary for the execution of the project.

20. The precise nature of the easements required by the project company would often depend on the nature of the project. They may include the right to place signs on adjacent lands, in the case of roads or railways; the right to install poles or electric transmission lines above third parties' property in the case of electricity distributors; the right to install and maintain transforming and switching equipment; the right to trim trees that interfere with telephonic lines placed on abutting property. In the light of the diversity of possible easements required in different projects, the host Government may find it preferable not to define in more precise terms the scope of those easements, leaving it to be established for each project individually.

21. A general legislative authorization to establish easements, as required by the project through expropriation, and without limiting their scope, might be contained in a provision similar to the following:

> In addition to the property required for the construction of the facility, the Government [the concessionaire] may establish easements in such other property, as are necessary for ensuring the access of the concessionaire to the facility as well as the erection or placement on or above such other property of such installations and affixtures, and the maintenance thereof, as are required for the functioning of the facility and the delivery of its services.

22. A somewhat different alternative might be for the law itself to provide the type of easements given to the project company, without necessarily requiring the expropriation of the property to which such easements pertain. Such an approach might be used in respect of sector-specific legislation, where the host Government deems it possible to determine, in advance, what easements might be needed by the project company. For instance, a law specific to the power generation sector might grant the following easements:

> The concessionaire shall have a right of cabling for the purpose of placing and operating basic and distribution networks on property belonging to third parties, which shall entitle the concessionaire to the following:
>
> (a) to establish or place underground and overhead cables, as well as establish supporting structures and transforming and switching equipment mounted on them;
>
> (b) to maintain, repair and remove any of the above installations;
>
> (c) to establish a safety zone along underground or overhead cables;
>
> (d) to remove obstacles along the wires or encroaching on the safety zone.

23. However, under some legal systems, the project company might be under an obligation to pay compensation to the owner, as would have been due in the case of expropriation, in the event the nature of the easement is such that the use of the property by its owner is substantially hindered.

B. Establishment of the concessionaire

1. The concessionaire as a consortium

24. National legislation on privately-financed infrastructure projects often contains provisions on the legal status of the concessionaire and deals with the question whether the concessionaire has to be established as an independent legal entity or whether the project may be awarded collectively to the selected project sponsors as project consortium. In a number of countries the law requires that the project company be established as an independent legal entity (see below, subsection 2), while in some countries the law authorizes the award of a project to a consortium formed by the project sponsors.

25. As understood in business practice, a consortium is a contractual arrangement whereby a group of enterprises undertakes to cooperate in carrying out a project without integrating into an independent legal entity. Consortia have been widely used in the construction industry for the development of large, capital-intensive projects requiring technical expertise in different fields. Consortia are commonly regarded as purely contractual arrangements which do not have a juridical personality of their own. However, there is no uniform legal regime governing consortia, which may fall under different contractual categories provided in national laws. Accordingly, the legal status of consortia and the rights and obligations of their members vary in different legal systems.

26. In the case of small-scale or short-term projects involving few sponsors, forming a project consortium may present some advantages, such as more flexibility in dealings among project sponsors and with their business partners than in the case of an incorporated joint venture. Avoiding double taxation may also be a reason for choosing not to establish an independent legal entity in the host country, in case there is no bilateral double taxation agreement between the host country and the country or countries where the foreign investors have their seats. However, for large-scale, long-term projects financed through non-recourse loans, a project consortium would not normally represent a viable alternative. A consortium would not be a suitable vehicle for borrowing funds, since in many jurisdictions the consortium members would have a residual and unlimited liability for the obligations of the consortium. Moreover, a consortium might not have access to the financial market for the purpose of raising funds, where only corporations are authorized by the law to issue negotiable instruments and securities such as stocks, bonds and debentures.

27. Also from the perspective of the host country it would normally be preferable that the project sponsors establish an independent legal entity in the country (see below, subsection 2). However, there might be instances where the host Government would wish to retain the possibility of engaging consortia for infrastructure projects, depending on the scale and nature of the project, or with a view to holding all project sponsors jointly liable for the entire project. For those countries, a decision about the desirable form of arrangement might need to be taken in the light of the characteristics of each particular project or type of infrastructure. For that purpose, the law

might give the procuring entity the option to award the project to a consortium or to require that a separate legal entity be established by the selected group of sponsors, depending on the needs of the project. Should the procuring entity consider that there would be no need for requiring the establishment of the project company as an independent legal entity, the law could address coordination difficulties that might arise in dealing with a consortium and clarify the responsibilities of its members. The law might for instance require that one member of the consortium be designated as responsible for the project vis-à-vis the host Government, while providing that all the remaining members of the consortium remain jointly and severally liable to the host Government for the execution of the project. An example of a provision to that effect might be as follows:

> 1. Where consortia are allowed to submit tenders [proposals], the solicitation of tenders [request for proposals] may provide that the procuring entity has the option to require that, if selected, the consortium must establish an independent legal entity prior to the signature of the project agreement.
>
> 2. If the procuring entity does not require the establishment of an independent legal entity, it shall require the following:
>
> (a) Submission of written proof of the agreement establishing the consortium entered by all its members; and
>
> (b) The appointment of one of its members as the leader of the consortium, who shall be responsible to the Government for the execution of the project.
>
> 3. The appointment of a consortium leader is without prejudice to the joint and several liability of the remaining members of the consortium to the Government for the execution and operation of the project. The project agreement shall be signed by all the members of the consortium.

28. A provision such as the above might help clarify some of the more obvious disadvantages of retaining a consortium for the execution of a project. However, a number of issues would still need to be addressed in the project agreement, and extensive negotiations and detailed provisions might be required to ensure coordination among members of the consortium, adequate liaison with the host Government, as well as clarifying the extent of responsibilities and liabilities of each of the members of the consortium for the execution of the project. 1/

1/ A brief discussion of issues arising out of contracting construction works with a non-integrated group of enterprises is contained in the *Construction Legal Guide* (chapter II "Choice of Contracting Approach", paras. 9-16). Some of the issues mentioned therein might also apply, *mutatis mutandis*, to negotiations concerning privately financed infrastructure projects, including the following: how the difficulty of bringing a claim

2. The concessionaire as an independent legal entity

29. In most cases, the law requires that the concessionaire be an independent legal entity which has to be incorporated prior to, or immediately after, the award of the project. Sometimes the law contains more detailed provisions concerning matters such as minimum capital, corporate form and purpose.

30. A project company established as an independent legal entity in the host country is for a number of reasons the structure normally used for infrastructure projects. It is relatively simple to vest all rights, assets and obligations related to the project in a single independent legal entity. Under such a model, the direct involvement of other parties such as the project sponsors may be limited, and the project company will enter into the project agreement and other instruments in its own name and will have its own personnel and management. An independent legal entity may also provide a mechanism for protecting the interests of the project, which may not necessarily coincide with the individual interests of all of the project sponsors. This aspect may be of particular importance for projects in which significant portions of the required services or supplies are to be provided by project sponsors. Since a substantial part of the liabilities and obligations of the project company, including long-term ones (project agreement, loan and security agreements, construction contracts), are usually agreed upon at an early stage, the project may benefit from being independently represented at the time those instruments are negotiated. Furthermore, a project company established as an independent legal entity allows a clear separation between the assets, proceeds and liabilities of the project and those of the project sponsors, thus facilitating accounting and auditing procedures.

31. One matter often dealt with in legislation on privately-financed infrastructure projects concerns the equity investment required for the establishment of the project company. The host Government has a legitimate interest in seeking an equity level that assures a sound financial basis for the project company and guarantees its capability to meet its obligations. Such interest may be satisfied by requiring that the project company be established with a certain minimum capital. In some countries, that issue is dealt with in the law itself, by prescribing a fixed sum or establishing a percentage of the total project cost as the minimum capital of the project company. In other countries, these issues are not addressed in the legislation and are left for the procuring entity to decide, sometimes after negotiations with the project sponsors.

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against project sponsors from different countries, should a dispute arise, may be overcome; how the dispute-settlement clause may be formulated so as to enable any dispute between the host Government and several or all the members of the consortium to be settled in the same arbitral or judicial proceeding; how guarantees to be given by third parties as security for performance and quality guarantees to be given by members of the consortium are to be structured; what ancillary agreements may have to be entered into by the Government; whether there are any mandatory rules of the applicable law governing an agreement with an unincorporated joint venture.

32. The total investment needed as well as the ideal proportion of debt and equity capital vary from project to project so that it would normally be difficult to establish a fixed sum or percentage that would be adequate for all instances. Thus, a legislative requirement of fixed sum as minimum capital for all companies carrying out infrastructure projects in the country may be excessively rigid. A more flexible approach might be to establish individual requirements taking into account the particular circumstances of each project or type of infrastructure. Where the total expected cost of the project cannot be estimated in advance by the procuring entity, the minimum capital required for the establishment of the project company could be indicated in the solicitation of tenders or request for proposals. Where it is not feasible to estimate in advance the project cost, or in the event the host Government prefers to negotiate the amount or ratio of equity investment offered by the project sponsors, the procuring entity might prefer to have the flexibility to arrive at an adequate minimum capital in the course of the selection process. In countries where the project is awarded by a formal act of the host Government (such as a decree or notice of award (see chapter IV, "Selection of the project sponsors" [yet to be drafted]), the required minimum capital of the project company could then be indicated in such act.

33. In addition to the question of minimum capital, national laws may contain provisions concerning the form under which the project company has to be organized. Some laws specifically require that the project company be incorporated as a certain type of company, while other laws make no provision on this subject. In cases where it is considered important to specify the form in which the project company is to be established, it is desirable to bear in mind the project sponsors' interest in ensuring that their liability will be limited to the amount of their investment. In order to avoid a subsidiary liability for payment of the project company's debts, the project sponsors will normally prefer to establish the project company as a limited liability company, such as a joint stock company. Project sponsors would be reluctant to carry out a project that would require them to assume unlimited liability for the project company's debts.

34. The issues discussed in the preceding paragraphs might be addressed by a provision such as the following:

> 1. The successful tenderer [proposer] shall, within [...] days from the award of the concession, establish the company with which the project agreement will be entered into.
>
> 2. The minimum capital, form, and duration of the project company shall be as provided in the solicitation of tenders [request for proposals] [notice of award of the concession].

35. Some laws contain provisions concerning the scope of activities of the project company, requiring, for instance, that the project company's activities be limited to the development and operation of a particular project. Such restrictions might serve the purpose of ensuring the transparency of the project's accounts and preserving the integrity of the project's assets, by segregating each project's assets, proceeds and liabilities from the assets, proceeds and liabilities of other projects or other activities not related to the project. Also, such a requirement may

facilitate the assessment of the performance of each project since deficits or profits could not be covered with or set off against debts or proceeds from other projects or activities. At the same time, however, the host Government might be interested in reserving the possibility of integrating other projects under a common management, in the event the same project company is awarded a complementary project in a separate selection process. A possible provision establishing such a requirement but allowing for exceptions might be drafted as follows:

> The purpose of the project company shall be limited to the execution and operation of the project for which the concession was awarded. Except as otherwise provided in the solicitation of tenders [request for proposals], a separate company shall be established for carrying out each project.

36. The host Government might also be interested in ensuring that the statutes and by-laws of the project company will adequately reflect the obligations assumed by the company in the project agreement, or that they will not hinder the execution of the project. Therefore, the law may provide that changes in the statutes and by-laws of the project company require prior authorization by the host Government. In requiring governmental approval for modifications of the statutes and by-laws of the project company, it is desirable to weigh the public interests represented through the State against the need for affording the project company the necessary flexibility for the conduct of its business. The daily management of the project might be impaired if even minor questions concerning the company's internal affairs routinely required prior governmental clearance. One possible solution might be to limit the possibility of the host Government objecting to a proposed amendment to those cases that concern provisions deemed to be of essential importance (e.g. amount of capital, classes of shares and their privileges, liquidation procedures) and which could be identified in the project agreement. The following is an example of a provision to that effect:

> The statute and by-laws of the project company and any amendment thereto requires prior approval by the Government, which is deemed granted unless the Government refuses approval within [...] days. The Government may refuse to approve amendments concerning essential provisions of the statute and by-laws [as provided in the project agreement], when such amendments are not deemed to be in the public interest.

37. The host Government may have a legitimate interest in ensuring that the original project sponsors maintain their commitment to the project throughout its duration and that they will not be replaced by entities unknown to the host Government. Thus, the law may provide, in addition to the matters mentioned above, that the transfer of voting shares of the project company shall require the prior approval of the host Government.

C. Approvals and licences

38. In some countries, the entry into force of the project agreement is sometimes subject to the approval of the host Government or an act of parliament, or even the adoption of special

legislation. For certain projects, approvals may be required at different levels of Government. The time required for obtaining such approvals varies greatly from country to country and in some cases may be considerable, particularly when the approving organs or officials were not originally involved in conceiving the project or negotiating its terms.

39. Delays in bringing an infrastructure project into operation may compromise its financial viability or cause considerable loss to its sponsors. Where the additional financial cost cannot be recovered by raising the tariffs or charging higher prices, the project company might turn to the host Government for redress or support. In both situations, the consequence might be an increase in the cost of the project and in its cost to the public. A possible denial of final approval to the project, or of another licence without which the project cannot be carried out, would have even greater consequences for the project sponsors. By the time the project agreement is signed, the project sponsors will normally have spent considerable time and invested significant sums in the project (e.g. preparation of feasibility studies, engineering design and other technical documents; preparation of tendering documents and participation in the tendering proceedings; preparation and negotiations of the contract documents and loan agreements; hiring consultants and advisers).

40. With a view to expediting matters and avoiding the adverse consequences of delays in the project's timetable, in some countries the authority to bind the host Government is delegated in the relevant legislation to designated officials, so that the entry into force of the project agreement occurs upon signature or upon the completion of certain formalities, such as publication in the official gazette. In countries where such a procedure might not be feasible, or in which final approvals by another entity would still be required, it would be desirable to consider ways to avoid such approval requirements functioning as a deterrent for prospective project sponsors accepting to undertake projects in the country. It might be important to bear in mind that the risk of the project being frustrated by lack of approval might be too high for the project sponsors to assume, and that the host Government might be requested to provide sufficient guarantees to the project sponsors and the lenders against such risk. In some countries where those requirements exist, Governments have sometimes agreed in the project agreement to compensate the project sponsors for all costs incurred and to repay any outstanding loans, in the event the final approval of a project is withheld.

41. In addition to approvals required for the entry into force of the project agreement, the development and operation of infrastructure projects usually involve a number of licences or authorizations required under the laws of the host country in respect of various specific activities (such as licences under foreign exchange regulations; licences for the incorporation of the project company; authorizations for the employment of foreigners; registration and stamp duties for the use or ownership of land; importation licences for equipment and supplies; construction licences; licences for the installation of cables or pipelines; licences for bringing the facility into operation). Such licences and authorizations may fall within the competence of various organs at different levels of the national administration and the time required for their issuance may be significant.

42. Some countries have found it helpful to coordinate the issuance of licences at an early stage of the execution of the project by identifying in advance the licences that will be required for

carrying out projects in specific sectors and providing that the procuring entity and the agency or agencies concerned with licensing the activity that is the object of the concession should agree on the terms and conditions for granting such licences before tenders are invited, such as in the following example:

> 1. Prior to issuing the solicitation of tenders [request for proposals], the procuring entity shall, in consultation with other organs and agencies concerned, identify all major licences and the agencies from which licences are to be obtained for setting up the project.
>
> 2. The current list of major licences required and the agencies from whom they are to be obtained shall be provided with the solicitation of tenders [request for proposals].

43. A provision such as the above might be complemented by a provision that entrusts one organ with the authority to monitor the issuance of such licences, as in the following example:

> 1. The [*regulatory body for the sector concerned*] shall be responsible for receiving the applications for licences, transmitting them to the appropriate agencies and monitoring the issuance of all licences listed in the solicitation of tenders and other licences that might be introduced thereafter.
>
> 2. Licences are deemed to be granted unless they are rejected in writing within [...] days of receipt of the application.

44. However, there might be instances where the host Government, for constitutional or other reasons pertaining to its internal organization, might not be in a position to assume responsibility for the issuance of all licences, or to entrust one single body with such a coordinating function. In that case, the host Government might wish to consider providing some assurance that nevertheless it will as much as possible assist the project company in obtaining licences required by national law, such as by designating an official or agency dedicated to provide information and assistance to project sponsors regarding the required licences to be obtained, as well as the relevant procedures and conditions.